

Universal Service Administrative Company ("USAC")

Agreed-Upon Procedures Report

For the year ended December 31, 2003

INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING
AGREED-UPON PROCEDURES

To the Board of Directors of the
Universal Service Administrative Company
Washington, D.C.

We have performed the procedures included herein, which were agreed to by the Universal Service Administrative Company ("USAC" or the "Company") and the Federal Communications Commission ("FCC"), solely to assist you and the FCC in evaluating whether the Company has fulfilled its responsibilities in accordance with the requirements promulgated by the FCC in Section 47 C.F.R. §54.717 of the FCC rules for the year ended December 31, 2003. USAC's management is responsible for USAC's compliance with those requirements. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described in Exhibit XXXXV either for the purpose for which this report has been requested or for any other purpose.

The procedures that we performed and our findings are included herein.

We were not engaged to, and did not perform an examination, the objective of which would be the expression of an opinion on compliance. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the specified parties listed above and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not restricted.

June 23, 2004

COMPLIANCE PROCEDURES

1. We read the certificate of incorporation and bylaws of the Universal Service Administrative Company (“USAC” or the “Company”) and noted that USAC is a wholly owned subsidiary of the National Exchange Carrier Association (“NECA”). In addition, we inquired of USAC management as to whether USAC has any financial investments in or is affiliated with any telecommunications service providers and were informed that in accordance with FCC Rules and Regulations, certain members of USAC’s committees are officers or employees of telecommunications service providers.
2. We inquired of USAC management about whether USAC’s Board of Directors is separate from NECA’s Board of Directors and were informed that the boards are separate.

We obtained the list of USAC’s Board of Directors in effect at December 31, 2003 and compared its composition with that as described in Section 54.703(b) of the Federal Communications Commission (“FCC”) rules. We were informed that while USAC is in compliance with FCC Section 54.703(b) in terms of the composition of USAC’s Board of Directors, there was one vacancy on the USAC Board of Directors at the time these procedures were performed. A representative of competitive local exchange carriers was no longer a member of the USAC Board of Directors at December 31, 2003 and this seat was vacant as of December 31, 2003.

3. We inquired of USAC’s accounting personnel as to whether USAC maintains its books of records separate from those of NECA and were informed that USAC does maintain its books of records separate from those of NECA.

We obtained USAC’s general ledger (“G/L”) for the year ended December 31, 2003 and USAC’s approved written accounting policies and procedures and we were informed that USAC’s G/L contains only the financial activities of USAC and the Universal Support Mechanisms (“USM”).

4. We obtained USAC’s 2003 annual payroll report detailing the officers and employees of USAC and the annual salaries paid including the basic rate of pay, bonuses, any non-regular payments and other compensation. We compared 2003 aggregate annual compensation including the basic rate of pay, bonuses, any non-regular payments and other compensation paid to each officer and employee of USAC to the 2003 basic salary limit of \$171,900 as defined by Level I of the Executive Schedule under Section 5312 of Title 5 of the United States Code (“USC”). The aggregate annual compensation paid per the 2003 annual payroll report including the basic rate of pay, bonuses, any non-regular payments and other compensation paid to each officer and employee of USAC did not exceed the Level I basic salary limit of \$171,900.

5. We obtained schedules prepared by USAC's accounting personnel comparing consolidated operating expenses and capital expenditures incurred during 2003 to budgeted amounts (Exhibits I and II). We agreed the consolidated operating expenses and capital expenditures on the USAC prepared schedules to USAC's trial balance at December 31, 2003. We compared the consolidated operating expenses and capital expenditures to budgeted amounts and identified operating expenses with a variance in excess of plus/minus 10% of the budgeted amounts (Exhibits I and II).

In addition, we performed the following:

- a. We obtained a schedule prepared by USAC's accounting personnel comparing the detailed operating expenses by G/L account for 2003 to the operating expenses by G/L account for 2002. We obtained explanations for the 2002 to 2003 variations from the USAC Finance Department for all accounts with a balance of \$100,000 or more where the increase was in excess of 20% as detailed in Exhibit III.
 - b. We obtained a schedule prepared by USAC's accounting personnel comparing the operating expenses by USM for 2003 to the budgeted operating expenses by USM for 2003. We obtained explanations provided by USAC Director of Finance for variations between actual and budget as summarized in Exhibit IV.
6. We obtained USAC's written policies and procedures and noted that finalized written policies and procedures had been approved and those that were in draft form were awaiting approval. We inquired of USAC management whether there is a process in place to provide reasonable assurance that the written accounting policies and procedures are in compliance with Part 54 FCC rules governing Universal Service and were informed that USAC management reads the policies and procedures for compliance before approval.
 7. We obtained USAC's Cost Allocation Manual ("CAM") and inquired of USAC's Director of Finance if the USAC CAM was in compliance with Part 54.702 (k), 715 (c) and 64.903 of the FCC rules. We noted that the CAM was amended on January 28, 2000 and we were informed by the USAC Director of Finance that it is in compliance with Part 54.702 (k), 715 (c) and 64.903 of the FCC rules.
 8. We obtained a year-end schedule of all debt and investment instruments. We randomly selected investments made by USAC during 2003 on behalf of the USM. For each selected investment instrument, we were informed that there were no direct investments in telecommunications service providers. As of December 31, 2003, we ascertained that USAC and USM did not have any debt outstanding on its G/L.

9. We obtained Section 54.702 (h) of the FCC rules from the National Archives and Records Administration Code of Federal Regulations website, <http://www.gpoaccess.gov/cfr/index.html>. We obtained USAC's G/L for 2003 and noted that separate G/L accounts exist for the following support mechanisms: High Cost, Low Income, Schools and Libraries and Rural Health Care. We inquired of and USAC management confirmed that Interstate Access Support and Interstate Common Line Support are part of the High Cost Mechanism, as directed by the Wireline Competition Bureau (formerly Common Carrier Bureau) of the FCC. Each support mechanism has a separate G/L account for cash, billings to contributors, receivables from contributors, disbursements to service providers and payables to service providers. We were informed by USAC's Director of Finance that actual billings to contributors, disbursements to service providers and payables to service providers are recorded in each support mechanism G/L account. We were further informed that cash collections from billings to contributors are allocated to the separate G/L cash and accounts receivable accounts of each support mechanism based on a program demand allocation factor.
10. Relating to the USAC 2002 audited financial statements and agreed-upon procedures reports we obtained a summary of USAC management's written response of corrective measures taken. We inquired of USAC management if the corrective measures described in their written response were implemented and were informed that corrective actions were taken for all economically feasible recommendations.

CONTRIBUTORS TO USF

1. We inquired of USAC and obtained the procedures used to identify telecommunications carriers subject to participation in the Universal Service Fund ("USF") and obtained an updated memorandum from USAC outlining these procedures. We obtained from USAC the list of USF contributors and randomly selected 20 contributors (Exhibit V) from the USF list of contributors. We compared the 20 contributors selected to the FCC database of carriers (FCC website <http://gullfoss2.fcc.gov/cib/form499/499a.cfm>) contributing to the Telecommunications Relay Services ("TRS") fund, the North American Numbering Plan Administration and the Local Number Portability Administration. We noted no exceptions.
2. We inquired of USAC and obtained the procedures in place for following up with non-responders to the FCC Form 499 data request. USAC provided an updated memorandum outlining the procedures for follow up. We obtained a data file of non-responders for filings due in 2003 and randomly selected a sample of 9 non-responders (Exhibit VI) from the data file. For the 9 non-responders selected, NECA calculated the non-responders revenue information for all 9 carriers to be exempt under the "de minimis rule." We were informed by USAC that as a result of the 9 carriers being exempt under the de minimis rule, no additional efforts were taken by USAC to follow up

on these non-responders, in accordance with the procedures outlined in the updated follow up procedures memorandum. We noted no exceptions.

3. We used the 9 filers from step 2 above as the sample (Exhibit VI) of de minimis filers. For each of the 9 carriers selected, we obtained the Form 499A filed in April 2003. Using the revenue information from line 420 columns (d) & (e), we recalculated the universal service contributions and compared the de minimis status for each to the de minimis database, noting no exceptions.
4. We inquired of management and obtained the written procedures in place regarding the process of reviewing Form 499s for errors, omissions, mathematical accuracy, and reasonableness.
5. We obtained the database of Form 499s by carrier for November 1, 2002, February 1, 2003, April 1, 2003, May 1, 2003 and August 1, 2003 filings from the USAC Data Collection Agent. We randomly selected 9 filers for each of the 5 filing dates mentioned (See Exhibit VII). We obtained the Form 499s for all 45 selections; however, three Form 499s (the May 2003 499Qs for filers 820076 and 819366 and the August 2003 Form 499Q for filer 802101) were not legible. For each of the 42 legible Form 499s which were obtained, we performed the following steps:
 - a. We recalculated the Form 499 for mathematical accuracy.
 - b. We agreed the carrier name, address and I.D. # to the USAC Carrier Master Database.
 - c. We noted that the service provider had certified the Form 499.
 - d. We noted the Form 499 had been reviewed by the USAC Data Collection Agent for reasonableness as noted by their sign off on the Form 499.

We noted the following exceptions:

- Filer ID 819688, Asiatone, LLC, Line 119 – Projected gross-billed end user revenues; no information provided and Line 120 – Projected collected end-user revenues; no information provided. We noted that this filer's Form 499Q filed in May was not initialed by any staff at NECA to indicate it was reviewed for reasonableness.
- Filer ID 819516, Essen Communications
We noted that this filer's Form 499Q for November was not dated by the filer.
- Filer ID 818666, Consolidated Lauco Systems
We noted that this filer's Form 499Q for November was not dated by the filer.

- Filer ID 801048, Wikstrom Telephone Company, Inc.
We noted that this filer's Form 499Q for February was not dated by the filer.
 - Filer ID 820061, Birch Telecom of Oklahoma, Inc.
We noted that this filer's Form 499Q for May was not dated by the filer.
 - Filer ID 818014, Ernest Communications, Inc.
We noted that this filer's Form 499Q for August was not dated by the filer.
6. We inquired of USAC management and obtained the procedures in place regarding the process of accurately summarizing and reporting revenue information obtained from the FCC Form 499 database to the FCC for its calculation of the contribution factor. We were informed by USAC that the process includes comparing and agreeing the total revenue reported and the number of filers contained in the FCC Form 499 database received from NECA to the details provided by NECA. We were also informed that the revenues reported in the Form 499 database are reduced by the Local and International Revenue Exception ("LIRE") and de minimis exemptions and is reviewed by a member of the USAC contributions team before submission to the USAC Finance Manager. We requested, but were not provided with, any written documentation that these processes had taken place in 2003. The noting of any differences between the information aggregated by USAC and the information sent to the FCC was performed under step 7a.
7. We obtained the quarterly filings that USAC management submitted to the FCC in 2003 and performed the following:
- a. We agreed the total end user revenue base amounts per the quarterly USAC filings to the total end user revenue base amounts in USAC's quarterly databases.
 - b. We randomly selected 10 carriers, from the sample in procedure 5 above, from among the four quarterly filings of the Form 499Qs and agreed the revenue information in USAC's quarterly databases to the carrier's actual Form 499Q.
 - c. Using the same sample of 10 carriers, we agreed interstate revenue, international revenue, and the total of these two items from the Form 499Q to USAC's database.

We noted the following exception:

Filer ID 819688, Asiatone, LLC – The contribution base per the USAC quarterly database did not agree with the filer's Form 499Q filed in May. This information could not be agreed to the filer's Form 499Q because the form was incomplete, which was already noted as an exception under step 5 above.

8. We inquired of USAC and obtained the procedures in place regarding the process for ensuring that the contributor's historical data is current. We obtained the database that compares the historical data to the current data and randomly selected 9 contributors with variations greater than 20%. Five of the selected contributors were calculated as being de minimis, as defined, and, in accordance with approved procedure, no further investigation was performed by NECA. For three of the remaining four contributors, we obtained copies of email correspondence in which NECA inquired of the contributor and the contributor responded with an explanation for the variance in their revenues reported. We were informed that no additional information could be provided for the remaining contributor as NECA's investigation has not yet been concluded.
9. We inquired of USAC and obtained the monthly procedures for preparing invoices and the quality control procedures to validate the accuracy of the invoices. We obtained documents outlining the policies and procedures of USAC for the preparation of invoices. We used the sample of 45 contributors selected in step 5 above, selected 5 contributors from each quarter and obtained the invoices for the second month of each corresponding quarter for the 20 contributors selected. We were informed by USAC Billing and Disbursement personnel that 2 carriers, Filer ID's 819830 and 821082, were calculated as being de minimis and therefore were not invoiced. For the 18 invoices received, we inspected and noted that they were prepared in accordance with USAC's policies and procedures. We also performed the following:
 - a. We proved the arithmetic accuracy of the invoices.
 - b. We agreed the carrier name, ID#, and revenue amount from the invoice to the applicable Form 499 filed by the carrier.
 - c. We inspected the invoice date noting that the invoices were sent out in the proper month.
 - d. We recalculated the invoiced amounts for each support mechanism based on FCC approved formulas and information from the Form 499.
 - e. We agreed the subsequent carrier receipts to the invoices and noted them to be in agreement with check images from the bank of the checks deposited into the lockbox and bank reports of ACH receipts. We noted

three exceptions: National Telemanagement Corporation, Asiatone, LLC and Ameritech Mobile Communications, Inc. USAC management informed us that discrepancies between the amount received and the amount billed are only followed up for the 20 largest filers. We were further informed that the three exceptions were not one of the 20 largest filers and were not investigated by USAC, in accordance with approved procedure.

- f. We agreed the daily lock box total to ACH receipt reports, check images and/or remittance slips from the bank. We were unable to agree directly to bank statements due to individual payments being made as part of a larger transfer.
10. We obtained USAC management's criteria and procedures for adjusting contributor liability amounts (amounts billed and amounts due from contributors) or contributor account balances and performed the following:
- a. We inquired of USAC's Billings personnel and obtained the procedures for adjusting contributor liability amounts. We were informed that USAC's policies and procedures are in agreement with FCC rules.
 - b. We randomly selected 10 contributors (Exhibit VIII) from a list of contributors who amended their November 2002 Form 499Q. We obtained a copy of all the amended 499Qs and also copies of the filers' April 22, 2003 invoices. We were informed that revisions were adjusted/credited to the filers' invoices equally over the three months of the quarter subsequent to the revised quarter. We then recalculated the revision for each month based on the revised Form 499Q and compared this recalculation to the adjustments/credits on the April 22, 2003 invoices. We noted the following exception:

Filer ID 803178, Randolph Telephone Company - We recalculated a monthly adjustment of \$996.15 which did not agree to the adjustment of \$11.14 per the April 22, 2003 invoice.

11. We inquired of USAC personnel and obtained the procedures performed when a contributor does not remit the required payment. We were informed that USAC's collection actions include past due notices and forced netting if the receivable remains unpaid after 90 days. We further noted that forced netting allows USAC to discontinue disbursements to contributors with past due balances. These disbursements are applied to the balance due, rather than disbursed, until the contributor's balance is current. In addition, each month USAC provides the FCC with a list of non-collectible receivables that represent contributors who are more than 90 days past due. We inquired of USAC personnel if FCC Notices of Apparent Liability ("NAL") were issued in 2003 and were informed that USAC was not notified by the FCC that a NAL was issued in 2003.

We were further informed that during 2003 the Debt Collection Improvement Act (“DCIA”) was passed and came into effect as of July 1, 2003. The DCIA requires USAC to turn over to the FCC all balances 90 days past due. The FCC then takes on all responsibilities for collecting these amounts.

12. We inquired of USAC and obtained the procedures implemented by USAC to comply with the DCIA. We selected 6 filers (Exhibit IX), 3 filers with balances that have been submitted (DCIA in process) to the FCC to be collected under the DCIA, and 3 filers whose balances have been received by the FCC (DCIA Transferred). We inspected supporting documentation for the filers selected and noted that they were submitted to the FCC in compliance with USAC’s policies and procedures. We traced the DCIA amount for the six filers to the accounts receivable analysis, noting no exceptions.
13. For each of the 20 invoices selected in step 9 above, we performed the following:
 - a. We obtained a detail of the subsequent cash receipts and supporting documentation, including wire transfer bank advices and check copies from the USAC Billings department and noted that each of the cash receipts was applied to their respective contributor accounts receivable balance except for the following cash receipt:

Filer ID 820061, Birch Telecom of Oklahoma, Inc. – A check to pay off the balances of multiple filers was applied fully to this Filer ID; however, we noted that USAC subsequently corrected the error in the ordinary course of business.
 - b. We noted that the subsequent cash receipts obtained in step 13 a are not identified by support mechanism. We were informed by USAC Accounting personnel that the monthly cash receipts are allocated across the support mechanisms using the ratio between mechanisms’ demands to total program demand, which is the ratio identified in USAC’s CAM submitted to the FCC.
14. For each of the 20 invoices selected in step 9 above, we noted the time lag between the invoice date and the date the subsequent cash receipt was received by the bank. We were informed that there would be no payments for three of the filers due to the fact that Filer IDs 819830 and 821082 were calculated as being de minimis and, in accordance with approved procedure, were not invoiced, and filer 802101 had a credit balance. We noted that 5 payments were made after the payment due date. We were informed by USAC’s Accounting personnel that there is an unmentioned 5 day grace period for payment. We noted that all 5 late payments in our sample fell under this grace period and no late payments were charged.

15. We inquired of the USAC Data Collection Agent if there were carriers that failed to submit FCC Form 499 by the due date for filings due in 2003. We selected 9 carriers (Exhibit X) which failed to file the Form 499Q, 5 which failed to file the May 2003 Form 499Q and 4 which failed to file the August 2003 Form 499Q. We noted that the procedures for estimating revenues for filers that did not file their Form 499s are contained in the memorandum documenting Form 499 non-responder follow up procedures. We obtained from the USAC Billings department the estimated Form 499Qs for the selected filers and agreed the information on the Form 499Q to the respective quarterly database.
16. We obtained USAC's G/L for 2003. We inquired of USAC management whether there were any funding excesses and/or shortages and were informed that there was a funding excess for the Schools and Libraries Support Mechanism and no funding shortages during 2003.
17. We obtained from USAC Accounting personnel a schedule of all data collection expenses, by month, indicating direct expenses and allocated expenses. We noted that the expenses were allocated among the various support mechanisms using the program size allocator as defined by the CAM.

PHYSICAL SECURITY/INFORMATION APPLICATION SAFEGUARDS

1. Management's policies and procedures regarding the safeguarding of USAC information through a confidentiality clause contained within the employee contract.

USAC

We inquired of USAC management about their confidentiality policies. We were informed that all USAC employees are required to sign a Non-Disclosure Agreement of Proprietary Information when they begin working at USAC. We noted the agreement defines for each employee of USAC proprietary information and how such information must be handled. We were informed that these agreements are maintained by the Human Resource office for reference as necessary for the length of each individual's employment at USAC and for 5 years after they leave USAC.

NCS PEARSON

We inquired of NCS Pearson management about their confidentiality policies and were informed that all new employees are required to complete a number of "new hire forms" prior to their first day of work. We were informed that one of these forms is the Confidentiality and Proprietary Property Agreement. We noted that this agreement states that the signer agrees to the non-disclosure of information

and/or property relevant to NCS Pearson or any of its affiliates during their employment with NCS Pearson. NECA

We inquired of NECA management about their confidentiality policies and were informed that all users are required to sign a Confidentiality Agreement form upon new hire. We noted that the Confidentiality Agreement states policies around protection of NECA's confidential information, and upon termination, sanctions for unauthorized taking of confidential information and trade secrets.

2. Management's organizational structure regarding the segregation of incompatible duties.

USAC, NCS PEARSON, NECA

We inquired of USAC, NCS Pearson and NECA Information Technology ("IT") management the organizational structure of the respective IT departments and were informed that the organization structures included those personnel with access to data. In addition, we inquired with USAC, NCS Pearson and NECA IT management of the procedures that would be followed in order for a change to be effected in the systems. We were informed that incompatible duties were segregated.

3. Management's policies and procedures to ensure that new application systems and modifications made to existing application systems (including ensuring that existing data that is changed / converted to new systems/applications is complete, accurate, and valid) are implemented in accordance with change management standards defined by management's procedural guidelines.

USAC

We inquired of USAC IT management their change management procedures and were informed that all change management projects follow a step-by-step phase approval process. We were further informed that each project is required to have the previous phase of the process approved in order to proceed and the approval must be received from the stakeholder and in some situations also from other senior management. We were informed that this authorization can only be granted via a manually signed Employee IT Resource Request Form. We obtained a sample of 8 Employee IT Resource Request Forms and noted that all of the forms were signed by both a manager and a director and that the request was detailed within the context of the form. We also observed each of the sample employees' access rights online with USAC management and we observed that their access reflected the rights that had been approved on the original request form. In addition, we observed the Systems Development Life Cycle Approach for USAC, as well as other supporting change management procedural documentation, noting that the

aforementioned procedures are documented and that approval by management is required. We further inquired of USAC management of their user acceptance test procedures and were informed that all processed changes are subject to a User Acceptance Test Plan that is defined by the USAC IT department in order to test the functionality of all changes made. We were informed that once this testing has been completed, the user manually signs off on the actual result and initials that the process was complete. We obtained 2 random sample User Acceptance Test Plans and noted that both were initialed, dated and approved by the user conducting the testing.

NCS PEARSON

We inquired of NCS IT management their change management policies and procedures and were informed that management approves all conversions of data via manual signature on all change request forms. In addition, we were informed that all change requests are processed through an online ticketing system directly to the IT call center. Further, we were informed that once a request is ticketed, it is assigned to the appropriate resource for processing. We were informed that prior to the change's movement to the test / production environment, the form must be printed, physically signed by an IT manager and then faxed back to the appropriate resource, as the request cannot go to testing / production stages without the manual signature. We were further informed that management monitors the conversion of data on a weekly basis via system Release Reports, which detail all changes made to the listed systems, etc. We observed example Release Reports and noted that they include an item tracker ID number, the title of the change or modification, and the steps that follow the modification with regard to final installation, testing, user acceptance, etc. In addition, we obtained the Pearson Change Control Policies and noted that the above mentioned controls are contained within the policy.

NECA HIGH COST

We inquired of NECA High Cost IT management their change management policies and procedures and were informed that a formal documentation change control policy is followed for all application development and programming changes. In addition, we were informed that the NECA IT Migration Form must be completed to migrate any programming change from one environment to another, regardless of the application, operating system, or other software. We obtained the NECA System Development Methodology and noted that the methodology describes the following phases for application development, and includes required deliverables before the next phase may begin: Project Definition; Analysis; Design; Construction; Quality Assurance Testing; User Acceptance Testing; Implementation; Review. We obtained the test plan for the High Cost Application and noted that it was formally documented on July 8, 2003. In addition staffing required for the parallel

testing was formally documented on July 25, 2003. We were further informed that a testing plan was developed and approved in April 2003. We were informed that the requirements of the NECA System Development Methodology are that Quality Assurance Testing and User Acceptance Testing be performed separately. However, due to the urgent nature of development of the High Cost application; these testing steps were combined into a single process. We were provided with management's authorization of the combination of these testing procedures.

NECA LOW INCOME

We inquired of NECA Low Income IT management their change management policies and procedures and were informed that only two changes were made to the Low Income application during 2003. We were informed that management cannot demonstrate the number of changes, as no log of application changes is maintained. Both requests were made by USAC management to NECA IT management; however, documented approval of these changes was not obtained. We were informed that the changes were deemed to be minor in nature and formal documentation of the design, development, and testing processes was not maintained.

In addition, we obtained the Low Income Migration Forms for the application modifications, dated March 11, 2003 and August 5, 2003, and observed that while the forms requested that the development change be migrated from the UAT to the PROD environment, we were unable to ascertain that the changes were actually tested in the development environment prior to implementation.

NECA SCHOOLS AND LIBRARIES AND RURAL HEALTH CARE

We inquired of NECA (RHC /SL) IT management of their procedures for system conversions and were informed that management approves the results of the conversion of data from old data structure to the new data structure and monitors that the conversion is performed in accordance with established conversion policies and procedures. We were informed that the process of change control is required in order to approve changes made to the SLD applications. We further were informed that the process begins with change forms submitted via email for migrations from quality assurance (QA) to user acceptance testing (UAT) environment. We were also informed that these changes are approved via email by the manager of UAT, then new change request forms are submitted via email from UAT to Production environment. We were informed that changes that are migrated to Production are approved via email by the Director of Program Systems.

We observed the use of the NECA Information Systems Migration Forms used for batch approval changes made to the SLD application and we

ascertained that forms are dated and changes are approved by a manager of UAT and the Director of Program Systems via email.

TELCORDIA

We obtained the Telcordia IT Change Control and Testing Session and were informed that all changes to High Cost/Low Income applications are required to be documented using a Change Request Form (CRF) which must be submitted to the Project Director. We were informed that Telcordia's process requires all changes to be evaluated, prioritized and tested using data and requirements provided by Rhoads and Sinon. We were further informed that Telcordia performs the tests and evaluates the test results against the requirements.

4. Management's controls in place to ensure that operating system security, LAN security, Application Security, & Remote Access Security (i.e.: Citrix and SecureID) is appropriately authorized, tested and implemented in order to prevent against unauthorized use, loss, or modification.

USAC

We inquired of USAC IT management their IT security policies and procedures as they relate to security, LAN security, application security and remote access security. We were informed that all users are granted access to USAC systems via an Access Request Form. We were informed that this form is required to be completed and signed by both a manager and a director before access is granted. We obtained a sample of 10 new user request forms and noted that the request forms were signed in accordance with approved procedure. We observed the user demonstrate the access privileges that were granted on the system and noted that system access was restricted to the functions that were noted on the form. We executed an automated security testing tool on the Windows environment hosting the key financial information resources at USAC and noted that users are assigned a password with their assigned username when they first get access to the network and any additional systems and this password must be changed upon their initial login and must conform to the given parameters. We obtained an independent and automated security report for the Windows environment and ascertained that the above settings are in place.

NCS PEARSON

We inquired of NCS Pearson IT management their IT security policies and procedures as they relate to security, LAN security, application security and remote access security. We were informed that all access to information resources is restricted by unique user IDs and passwords via the NCS Pearson LAN login. We were informed that usernames consist of the first 4 characters of the user's last name followed by the first 2 characters of the user's first

name. Additionally, we were informed that the number "9" is added to the username if the user is considered a contractor or to have contractor rights and privileges. (NECA creates usernames and passwords for both the SLD Internal Area and the Siebel system). We were informed that all usernames are assigned by management and passwords follow parameters set by NCS IT management. We randomly observed screens for the LAN and PCS settings and noted that parameters were in place.

NECA

We inquired of NECA IT management their IT security policies and procedures as they relate to security, LAN security, application security and remote access security. We were informed that NECA has developed IT Policies and Procedures, which are documented in the Information Processing Manual ("IPM"). We obtained the IPM security policy and noted that it contained the following sections: A.1 Purpose; A.2 Basic Principles for Staff Members and Contract Employees; A.3 Roles and Responsibilities of Staff; A.4 E-Mail Policy; A.5 Internet Usage and Web Pages; A.6 Intranet Usage and Web Pages; A.7 Software Copyright Compliance; A.8 PC Desktop Procedures; A.9 Notebook Procedures; A.10 PDA Procedures; A.12 User ID and Password Procedures; A.13 Software Licensing.

HIGH COST/LOW INCOME

We obtained documentation for the High Cost Excel spreadsheets initiative, for the period January through November 2003 and observed that the spreadsheets used prior to September 2003 did not include security features. This feature was introduced with the implementation of the new web-based application, for which no security procedures were performed because the application was transferred to another USAC vendor prior to the performance of our agreed-upon procedures. We noted that the documentation stated that the security parameters met or exceeded those specified in the information processing manual.

We were unable to obtain the documentation for the High Cost Webserver initiative and the High Cost Windows Webserver for the period January through November 2003. We noted that the documentation stated that the security parameters met or exceeded those specified in the information processing manual.

We were unable to perform agreed-upon procedures related to security for the Low Income initiative for the period January through November 2003 as the application had been transferred to another USAC vendor prior to the performance of our agreed-upon procedures. We noted that the documentation stated that the security parameters met or exceeded those specified in the information processing manual.

We obtained an automated security report for the LI AIX Server for the period January through November 2003 and we noted that the report indicates security on the server was average.

We obtained two BindView reports, dated April 3, 2003 and December 30, 2003 for the Novell LAN Server and observed the Novell Netware Intruder Detection Settings. We observed that unauthorized attempts to access the Novell Netware are not logged; however an account is locked after 3 incorrect login attempts.

We were informed that a Citrix server is used, in combination with a SecureID to authenticate remote users who access the High Cost and Low Income applications. We were further informed that the SecureID is a device that provides a one-time random number that is entered, and approved by the SecureID application housed on the Citrix server. We were also informed that the Citrix server serves to encrypt information that is transmitted to/from remote users.

NECA SCHOOLS AND LIBRARIES AND RURAL HEALTH CARE

We inquired of the Director of Computer Support Services, and the Manager of IT Security Services, the Unix information security tools and techniques in place to restrict access to information resources. We were informed that access to the SLD application system is restricted by Unix AIX security. We were further informed of the following: - AIX proprietary security will shadow passwords; All Users are assigned unique user IDs; Passwords are required by all users; Password expiration is every 5 weeks; Passwords require at least one numeric character; Users are not allowed to reuse the same password for 52 weeks. We inquired of the Director of Computer Support Services the logical security settings and were informed of the following: AIX proprietary security ensures user password shadowing; All Users are assigned unique user IDs; Passwords are required by all users; Password expiration is every 5 weeks; Passwords require least one numeric character; Users are not allowed to reuse the same password for 52 weeks.

We inquired of the Senior Manager Developer, and a Developer, the access to Siebel application and discussed the two levels of security controls. We were informed that the first level of control is administered at NECA at the database level and the second level of access is administered within the Siebel application. We observed the screen shot (created using Query Analyzer) of the high level DBA access with the developer. We observed that the top window of this Microsoft tool is the SQL statement executed with the results in the bottom section. The rows which contain Built-in, SA, and USAC_APPS are system generated at database creation time. SADMIN is the Siebel Administrator ID and required by the Siebel application. CAPPS and

RDOO are developers out in Pearson who maintain the application. We inquired and ascertained that this level of access is required to provide support.

TELCORDIA

We obtained the High Cost/Low Income System Maintenance and Support Procedures and observed that the policies contain information on the security and administration procedures for the High Cost/Low Income applications.

5. Management's controls in place to ensure that physical access restrictions are implemented and administered to ensure that only authorized individuals have the ability to access or use information resources and the protection of information resources against environmental hazards and related damage.

USAC

We inquired of the USAC Director of IT the access of the USAC facility and data center environment. We were informed that access is restricted through the use of employee key cards throughout the facility. We were further informed that all USAC Window servers and systems hosting the key financial information resources are located at an off-site facility – ServerVault. Through inquiry, we were informed that the only employees with administration rights (through an administration specific account) at ServerVault include the following: Director of IT; Network Manager; Network Engineer.

We observed the ServerVault TruSecure Certification held by USAC and noted that as a TruSecure customer, ServerVault has its security controls, policies and procedures examined, measured, and validated against a stringent set of practices as defined by TruSecure Corporation. We obtained the TruSecure certificate documentation.

NCS PEARSON

We inquired of the physical access controls in place at NCS Pearson with the Project Manager and Program Manager. We were informed that access to the Pearson facility is controlled via employee key cards, based on the particular employee's job function.. We were further informed that all new user access requests or user access modifications are done through the Help Desk. We were also informed that before a user can obtain access to the LAN, to the specific applications and systems or even obtain a key card, his or her manager or supervisor must manually approve an Access Request Form. This form includes all access request information and must be manually signed before any access is granted. We randomly obtained Access Request Forms for NECA Agent Users on Pearson systems and noted that all forms were manually signed by management level personnel or above. We obtained a

random sample of five Access Request Forms and observed the system access of each employee as related to their original request form. We ascertained that the access rights were recorded on the approved access forms.

NECA HIGH COST, LOW INCOME, RURAL HEALTH CARE AND SCHOOLS AND LIBRARIES

We obtained a list of all NECA employees with access to the computer processing room. We observed only two doors providing access to the computer processing room and noted that for both doors, access is granted via the employee id badge. Through inquiry we were informed that if authorization is provided by the IT department, the employee badge is encoded with access rights to the computer processing room. Through inquiry of the Director Computer Services Support, we were informed that an employee's badge is coded to provide access to the computer room only if approved by the Director Computer Services. We were informed that the Director Computer Services periodically reviews the Computer Room Access report for appropriateness. We were further informed that steps are in place for temporary access and are provided only to authorized individuals for a limited period of time.

6. Management's controls in place to ensure that management monitors Information Security service levels and initiates corrective action if performance does not meet expected service levels, as specified by management.

USAC AND NCS PEARSON

We inquired of the Director of IT their policies and procedures to monitor Service Level Agreements and were informed that in the event that performance does not meet expected service levels as specified in these agreements, management will take proper corrective action. We were further informed that users will notify management if there are system related outages. We obtained the Service Level Agreement maintained between USAC and the contractor NECA (and NCS Pearson) and noted that USAC proposes a set of goals annually. We were informed that these goals are agreed upon by the contractor and USAC and address the way in which the support mechanisms will be administered and set targets for the contractor and USAC for the upcoming year. We were informed that on a quarterly basis the contractor and USAC meet to determine priorities and assess performance against the agreed upon goals at which time any recalibration of priorities is done. We were further informed that at the end of each contract year, the contractor and USAC meet for an evaluation conference. We were informed that the purpose of this meeting is to review goal performance and other contractual obligations and to set goals for the coming year.

NECA HIGH COST, LOW INCOME, RURAL HEALTH CARE, AND SCHOOLS AND LIBRARIES

We inquired of the Executive Director - Information Systems and the Manager of IT Security Services the Service Level Agreements between NECA and USAC. We were informed that NECA management monitors information system service levels and initiates corrective action if performance does not meet expected service levels. We were informed that on a quarterly basis NECA and USAC will meet to determine priorities and assess performance of service levels against the agreed upon goals. We were informed that at the end of each contract year, NECA and USAC management will meet for an evaluation conference. We were further informed that the purpose of this meeting is to review goal performance and other contractual obligations and to set goals for the coming year. We obtained the USAC-NECA Contract for Schools and Libraries Division (SLD) and Rural Health Care (RHC) and noted that the service levels are defined in "Performance Criteria, Incentives and Credits" section of the contract. We further ascertained that service levels pertain to Call Center measurements, Web Site availability and other support for both SLD and RHC.

7. Management's controls in place to ensure that adequate plans exist for the backup of critical resources and that a disaster recovery plan has been established and is tested at least annually.

USAC

We inquired of the Director of IT at USAC their procedures in place around Business Continuity and Disaster Recovery Planning and were informed that a business impact analysis was conducted at USAC during 2003. We were further informed that various business continuity measures are in place, such as redundant information systems in many instances, offsite tape backups, etc. We inquired of the procedures for recovery using existing servers at an alternative location and were informed that USAC is in the process of selecting a "Hot Site" location for backup and recovery purposes. We obtained the Business Continuity Plan for USAC and noted that procedures and policies to be followed in the event of an emergency are documented for reference. We were informed that the plan is tested on a yearly basis.

We inquired of the Director of IT at USAC their procedures in place around off-site backup retention of data and were informed that USAC has established an off-site backup tape storage agreement with First Federal. We obtained random example backup logs / retention schedules for data sent off-site and also obtained authorization listings showing those individuals with access to retention data. We were informed that USAC maintains a formal backup schedule which defines what systems are backed up when. We were

further informed that only authorized USAC IT personnel have access to First Federal storage data.

NCS PEARSON

We inquired of the Software Project Manager and the Senior Systems Engineer the business continuity planning at Pearson. We were informed that an enterprise wide business continuity / disaster recovery plan has been prepared and approved by management and includes all policies and procedures to be followed, both from a personnel standpoint and a systems standpoint. We were informed that the plan was tested in 2002 due to a tornado warning in the area. We obtained the Pearson Full Business Continuity Plan for Lawrence, Kansas and observed that the aforementioned items are included in the document.

NECA HIGH COST, LOW INCOME, RURAL HEALTH CARE AND SCHOOLS AND LIBRARIES

We inquired of the Executive Director - Information Systems and the Manager of IT Security Services their disaster recovery plan procedures and were informed that NECA conducted a business impact assessment in 2002 and finalized a Disaster Recovery Plan in 2003. We were informed that during the 18 months that the plan was being developed, it was repeatedly tested by the Disaster Recovery Plan (DRP) team, who would then recommend changes to the plan, based on the test results. We were informed that the foundation of the plan is the data center at the Alpharetta, GA regional office; which serves as a backup data center. We were informed that the plan includes DRP team member contact information; hardware and software inventory; and recovery steps required if a disaster is declared.

We inquired of the Executive Director - Information Systems and the Manager of IT Security Services the backup procedures and were informed that the Tivoli Backup Procedures are followed to perform the daily backups at NECA. We were further informed that the procedures include a backup schedule for all data. Also included is an Outline of Procedures to be followed within the Tivoli software, a retention schedule, and off-site storage policies.

TELCORDIA

We obtained the High Cost/Low Income Disaster Recovery Plan and noted that it contained steps outlining the recovery procedures that should be followed in the event of a disaster. We also obtained the High Cost/Low Income System backup and Restore Procedures and noted that procedures were described for Docushare, SQL and Oracle.

8. Management's controls in place to ensure that the data structure is appropriately implemented and functions consistent with management's intentions and that modifications made to the existing data structure are timely and valid.

USAC

We inquired about the testing of new data structures and modifications made to data structures with the Director of IT and the Network Manager and were informed that all changes are made following the System Development Life Cycle Plan and that appropriate time is allocated for testing. We obtained the Systems Development Life Cycle Approach plan for USAC, as well as other supporting change management procedural documentation, and observed that the testing procedures are documented and that approval by management is required. We were further informed that all processed changes are subject to a User Acceptance Test Plan that has been defined by the USAC IT department in order to test the functionality of all changes made in order to ensure accurate, complete and authorized processing.

We obtained 2 random sample User Acceptance Test Plans: one for the testing of the functionality of the DCIA Automated Interface application and one for the testing of the functionality of the E-Statement Application. We noted that both were initialed, dated and approved by the user conducting the testing.

NCS PEARSON

We inquired of the Software Project Manager Senior and Systems Engineer of their approval process for user and other requests for modifications to data structures. We were informed that management approves all data structure modification requests via manual signature on all change request forms. We were informed that all change requests are processed through an online ticketing system directly to the IT call center and once a request is ticketed, it is assigned to the appropriate resource for processing. We were informed that prior to the changes movement to the test / production environment, the form must be printed, physically signed by an IT manager and then faxed back to the appropriate resource, as the request cannot go to testing / production stages without this manual signature. We were further informed that management monitors the conversion of data on a weekly basis via system Release Reports, which details all changes made to the listed systems, etc. We obtained example Release Reports, noting that they include an item tracker ID number, the title of the change or modification, and the steps that follow the modification with regard to final installation, testing, user acceptance, etc.

We inquired of the Software Project Manager and Senior Systems Engineer of the testing procedures for new data structures and modifications to data

structures. We were informed that all procedures regarding change management are tested in accordance with testing plan documentation that has been approved by management. We were informed that all items approved for the testing stage are discussed by key IT management personnel to determine their appropriateness regarding testing plans and migration to production. We obtained several random examples of meeting minutes from IT committee meetings held to discuss testing and change management phases in the development life cycle and noted that the meetings included discussions regarding both necessary changes and changes in progress and their status / user acceptance.

We obtained the Change Management Documentation for Pearson and noted that all policies and procedures regarding change control are detailed. We obtained a random example change management project plan and noted that the plan included approval at various levels along with time allocated to sufficient testing.

NECA HIGH COST/LOW INCOME

We were informed that all data structure changes are implemented following the same procedure as application changes. We also noted that there is no method to distinguish between application code changes and database structure changes. Refer to step 3 regarding application changes.

NECA RURAL HEALTH CARE AND SCHOOLS AND LIBRARIES

We inquired of a consultant and a Senior Manager Developer of the approval process for system and/or data changes and were informed that the process of change control is required to be initiated in order to approve changes made to the SLD applications. We were informed that the process begins with change forms submitted via email for migrations from QA to UAT environment and that these changes are approved via email by a manager of UAT. We were further informed that after the changes are approved in the UAT environment, new change request forms are submitted via email from UAT to Production environment. We were also informed that changes that are migrated to Production are approved via email by the Director of Program Systems.

We inquired of a consultant and a Senior Manager Developer the NECA Information Systems Migration Forms used for batch approval changes made to the SLD application. We were informed that forms are dated and changes are approved by both the manager of UAT and the Director of Program Systems via email.

9. Management's controls in place to ensure that all production programs needed to process batch and on-line transactions are executed timely and in the proper sequence, as defined by USAC management, to normal completion.

USAC

We inquired of the operations processes at USAC with the Director of IT and the Network Engineer. We were informed that all jobs scheduled are monitored by the Director of IT to ensure successful and timely completion, including the review and resolution of any identified exceptions. We were informed that all systems at USAC have enabled error logging. We were informed that exceptions are tracked automatically for servers using event log monitoring by IPSentry and all systems are monitored using Whats Up Gold by Ipswitch which is also used to report uptime metrics. We were informed that all alerts are investigated by management and outages are reported using a Reason for Outage (RFO) report. We were informed that escalation uses the USAC IT department contact list in addition to the escalation list maintained for external vendors.

We observed both the Whats Up Gold and Big Brother monitoring systems online with the Director of IT and the Network Engineer. We observed that the aforementioned information was available online and that it is being reviewed consistently by IT management. We observed that all systems/servers running are displayed, and we were informed that in the event that a problem should arise the color of the identified system/server would turn red. We further observed that these monitoring screens are looked at periodically throughout the day by IT management.

NCS PEARSON

We were informed that there are no batch transactions at NCS Pearson as related to USAC systems and all changes are made real-time.

NECA HIGH COST

We were informed that there are no batch transactions at NECA High Cost as related to USAC systems and all changes are made real-time.

NECA LOW INCOME

In December 2003, the Low Income application was transferred to another USAC vendor and, as a result, we were unable to perform specific agreed-upon procedures regarding the transactions. We did however inquire of the Executive Director - Information Systems the procedures for job scheduling and process and were informed that three processing jobs are activated and monitored by the Operations department in support of the Low Income application. We were informed that each month, upon receiving proper authorization from the High Cost/Low Income Application Manager, the first job is activated. We were informed that when successfully completed, notice

is sent to the High Cost/Low Income Application Manager who then authorizes activation of the second job and the same process is then followed until the third job is activated and completed. We further were informed that if processing exceptions occurred, the restart/recovery procedures outlined in each respective document were followed. We noted that documentation of this process was not maintained by the Operations department; but rather by the High Cost/Low Income Application Manager.

NECA RURAL HEALTH CARE/SCHOOLS AND LIBRARIES

We inquired of a consultant and a Senior Manager Developer the job operations process and were informed that users review completed processing to ensure complete and authorized jobs were scheduled and completed successfully. We were further informed that the consultant monitors the SLC production jobs in the SLC log file created from the Control-M job scheduler to ensure complete succession and the SLC log file creates summarized information of the job logs for any errors captured in the log file. We obtained the SLC production job log noting the existence of the various production jobs in the UNIX environment. We noted that the jobs were complete with no errors by observing the "Total errors captured" section of the log file.

10. Management's controls in place to ensure that information systems strategies, plans, and budgets are consistent with the entity's business and strategic goals. In addition, modifications to existing systems software, network and communications software and computer hardware are appropriately implemented timely and consistent with USAC's management intentions.

NECA

We inquired of the Director of IT the policies and procedures around information systems strategies, plans, and budgets at USAC. We were informed that USAC has a corporate wide strategic planning initiative underway. We were informed that IT plans are aligned to support strategic initiatives. We obtained a recent IT strategic plan as well as 2004 budgetary information and were informed that all plans and budgets are reviewed on a regular basis by management to ensure that all plans maintain consistency with the overall strategic goals at USAC.

We inquired of the USAC Director of IT the modifications made to existing system software and computer hardware and were informed that all changes are made following the System Development Life Cycle Plan and that time is allocated for testing. We obtained the Systems Development Life Cycle Approach Plan for USAC, as well as other supporting change management procedural documentation and noted that the testing procedures are

documented and that approval by management is required. We also noted that all processed changes are subject to a User Acceptance Test Plan. We ascertained that this test plan has been defined by the USAC IT department in order to test the functionality of all changes made in order to ensure accurate, complete and authorized processing and it consists of specific tests to be carried out and their expected result. We ascertained that once this testing has been completed, the user manually signs off on the actual result and initials that the process was complete. We obtained 2 random sample User Acceptance Test Plans: one for the testing of the functionality of the Automated Interface Application and one for the testing of the functionality of the E-Statement Application. We noted that these were initialed, dated and approved by the user conducting the testing.

NECA HIGH COST, LOW INCOME, RURAL HEALTH CARE AND SCHOOLS AND LIBRARIES

Management indicated that a formal document has been prepared by NECA that outlines the policies and procedures for infrastructure changes. We were informed that all infrastructure changes, including patches/updates/upgrades to database software, network and communications software, security software, operating system software, other system software, and hardware are covered by the document. We were also informed that the Change Management process will also serve to notify the Help Desk when changes are implemented and the Help Desk will use this information for problem determination and resolution. We ascertained that this document also requires weekly meetings of the Change Management Committee and for minutes of such meetings to be maintained. We obtained a sample of meeting minutes and noted that no meeting was held during one of the requested weeks and all other minutes were provided. Management further indicated that all requests for modifications to NECA's infrastructure must be submitted on an IT Request for Change form. We were informed that proper authorization from IT management must be received before the change will be scheduled. We obtained a log of all infrastructure changes that took place during 2003. We obtained a random sample of changes and noted that a copy of the appropriately authorized IT Request for Change forms were requested and received.

HIGH COST SUPPORT MECHANISM

General Procedures

1. We obtained the FCC High Cost Filing (appendix HC01) for all four quarters of 2003 and noted, by study area code, the total annual high cost support amount each carrier received.

2. We obtained the total annual support amount for each High Cost Support Mechanism component and calculated the percentage of each component to the total support (Exhibit XI).
3. We obtained the carriers' total annual support amount and sorted it by: a) rural versus non-rural; b) cost versus average schedule; c) incumbent versus competitor (Exhibit XII). For each classification (for example, rural, non-rural, incumbent, competitor), we calculated the percentage of each group to the total support.
4. We randomly selected the following incumbent carriers for testing: a) 10 carriers receiving High Cost Loop Support ("HCL") (Exhibit XIII); b) 5 carriers receiving High Cost Model Support ("HCM") (Exhibit XVI); c) 10 carriers receiving Long Term Support ("LTS") (Exhibit XVII); d) 5 carriers receiving Local Switching Support ("LSS") (Exhibit XX); e) 10 carriers receiving Interstate Access Support ("IAS") (Exhibit XXII); and f) 10 carriers receiving Interstate Common Line Support ("ICLS") (Exhibit XXIII). We inquired of management and they agreed that the list of carriers selected for these agreed-upon procedures encompasses all high cost support received. In addition, we compared this sample to the percentage of each group identified in steps 2 and 3 above and noted that it approximately represents the same percentage.
5. For the carriers selected in 4 above that were designated within the last three years, we read the ETC designation order and noted that the carrier was designated when support was received. We noted the areas in which the carrier has been designated to serve. We noted no exceptions.
6. For the carriers selected in 4 above, we obtained the annual certification(s). We noted without exception that all selected certifications were timely submitted (due 10/1/02 for HCL, LSS, and HCM; due 6/30/02 for IAS and ICLS, and due 6/30/03 for LTS) and all selected certifications include a reference to CC Docket No. 96-45 and a statement that *"the support provided will be used only for the provision, maintenance, and upgrading of facilities and service for which the support is intended."*

High Cost Loop Support

7. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have relating to the completeness and reasonableness of input data items. We inquired of management and were informed that only authorized input is accepted for processing.
8. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have

to ensure that only one data submission is processed for each cost company. We inquired of management and were informed that no changes were made to each Eligible Telecommunications Carrier's (ETC) high cost data submission without the proper documentation and authorization.

9. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure the ETCs high cost data is reasonable in relation to the ETCs historical data and expected results.
10. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure a post-processing review of high cost data is performed in accordance with management criteria. We inquired of management and were informed that a post-processing review is performed.
11. Using the sample of carriers selected above, we noted that the rural carrier's classification on file is in agreement with the FCC for incumbent carriers receiving HCL.
12. For the incumbent carriers selected in 4 above, we ascertained their competitors. We obtained the effective date of the competitor's ETC designation order and noted that the carrier was designated as an ETC prior to receiving support. We obtained the annual state certification for timeliness (due 10/1/02) and ascertained whether the competitor's ETC designation order was granted at a level different than the incumbent. We noted no exceptions.
13. For competitor ETCs we obtained from NECA (in part as its role as USAC's vendor and in part in its role under Part 36 of the FCC's rules) line count data submitted as of September 30, 2002, that was filed on March 30, 2003 and support payment disbursed in the third quarter 2003.
14. We recalculated the competitor's support received in the third quarter 2003 and noted that it was in agreement with applicable FCC rules (Exhibit XIV). We noted that the carrier's support amount was computed based on the disaggregation path selected. We compared the recalculation to the NECA detail disbursement authorization and noted a difference of \$40 for Grand River Mutual of Missouri. However, we noted that the calculation of cost and expense data for HCL is subject to NECA's role under Part 36 of the FCC rules, and as such were advised by USAC management not to investigate this matter further.
15. We randomly selected September 2003 and inspected the disbursement authorization for adequate review by management.

- a. We obtained documentation and noted that the Service Provider Identification Number (“SPIN”) assigned to the carrier to make support payments agreed to the proper study area code for which support was eligible. We noted no exceptions.
16. For the sample selected, we identified carriers receiving Safety Net Additive (“SNA”) support and noted that support is consistent with the formula contained in Section 36.605(b) of the FCC’s rules. We noted no exceptions.
17. We noted that all carriers receiving SNA support have filed a certification that the study area has realized growth in end of period Telecommunications Plant in Service (“TPIS”), on a per-line basis, of at least 14% more than the study area’s TPIS per-line investment at the end of the prior period. We noted that the certification was received on or about the time of the carriers’ annual or quarterly data submission.

High Cost Model Support

18. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure that input data items are complete and reasonable. Through observation, we ascertained that only authorized input is accepted for processing.
19. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure that only one data submission is processed for each cost company. Through observation, we ascertained that no changes are made to an ETCs high cost data submission without the proper documentation and authorization.
20. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure the ETCs high cost data is reasonable in relation to the ETCs historical data and expected results.
21. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure a post-processing review of high cost data is performed in accordance with management criteria. Through observation, we ascertained that a post-processing review is performed.
22. For incumbent carriers receiving HCM, we recalculated the distribution of forward-looking support according to the applicable FCC rules and agreed the support had been calculated in accordance with applicable FCC rules

(Exhibit XV). We noted the state in which the selected carriers serve and ensured each state is qualified to receive HCM.

23. For the HCMS incumbent carriers selected, we identified their competitors (Exhibit XVI). We obtained the effective date of the competitor's ETC designation order and ascertained that the carrier was designated as an ETC prior to receiving support. We inspected the annual state certification for timeliness (due 10/1/02) and ascertained whether the competitor's ETC designation order was granted at a level different than the incumbent. We noted no exceptions.
24. For one incumbent ETC, Mountain Bell WY, and one of its competitors, Western Wireless, we obtained from NECA (in part in its role as USAC's vendor and in part in its role under Part 36 of the FCC's rules) line count data submitted as of December 31, 2002, that was filed on July 31, 2003 and support payment disbursed in the third quarter 2003.
25. With the assistance of NECA personnel, we reperformed the calculation of support per the model for the incumbent and competitor selected. We ascertained that this calculation was in agreement with applicable FCC rules and and agreed any data which was manually entered by NECA (e.g., that which is not a data feed) to source documentation. We compared this recalculation to the NECA detailed disbursement authorization, noting no exceptions.
- 25 a. We noted that disbursements were calculated using both the Forward-Looking Cost Model and the Hold Harmless methodology. We ascertained that the amount calculated by the Hold Harmless method, excluding LTS, is reduced by \$3.00 annually in the average monthly per-line support. We noted that the disbursements to the carriers were at the higher of these two amounts.
26. We randomly selected September 2003 and inspected the disbursement authorization for adequate review by management.
 - a. We obtained documentation and ascertained that the SPIN assigned to the carrier to make support payments agreed to the proper study area code for which support was eligible. We noted no exceptions.

Long Term Support

27. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure that input data items are complete and reasonable. We inquired of management and were informed that only authorized input is accepted for processing.

28. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure that only one data submission is processed for each cost company. We inquired of management and were informed that no changes are made to an ETCs high cost data submission without the proper documentation and authorization.
29. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure the ETCs high cost data is reasonable in relation to the ETCs historical data and expected results.
30. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure a post-processing review of high cost data is performed in accordance with management criteria. We inquired of management and were informed that a post-processing review is performed.
31. For incumbent carriers receiving LTS, selected in the sample in 4 above, we ascertained that the carrier participates in NECA's common line pool.
32. For the LTS incumbent carriers selected, we ascertained their competitors (Exhibit XVII) and the effective date of the competitor's ETC designation order and we noted that the carrier was designated as an ETC prior to receiving support. We obtained the annual self certification for timeliness (due 6/30/03) and ascertained whether the competitor's ETC designation order is granted at a level different than the incumbent. We noted no exceptions.
33. We recalculated the incumbent and competitor's support received in the third quarter 2003 and noted that it is in agreement with applicable FCC rules (Exhibits XVIII and XIX). We ascertained that the carrier's support amount was computed based on the disaggregation path selected. We compared the recalculation to the NECA detailed disbursement authorization, noting no exceptions.
34. We randomly selected September 2003 and inspected the disbursement authorization for adequate review by management.
 - a. We obtained documentation and ascertained that the SPIN assigned to the carrier to make support payments agreed to the proper study area code for which support was eligible. We noted no exceptions.

Local Switching Support

35. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure that input data items are complete and reasonable. We inquired of management and were informed that only authorized input is accepted for processing.
36. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure that only one data submission is processed for each cost company. We inquired of management and were informed that no changes are made to an ETCs high cost data submission without the proper documentation and authorization.
37. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure the ETCs high cost data is reasonable in relation to the ETCs historical data and expected results.
38. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure a post-processing review of high cost data is performed in accordance with management criteria. We inquired of management and were informed that a post-processing review is performed.
39. For incumbent carriers receiving LSS, selected in the sample in 4 above, we ascertained that the carrier was rural by agreeing the carrier's rural classification on file with the FCC and that it had no more than 50,000 access lines at December 31, 2002.
40. We inspected the 2001 LSS forms for five incumbent carriers selected in 4 above, in order to obtain the projected line counts submitted October 1, 2000. In addition, we obtained the true-up forms filed in December 2002 and compared the true-up amounts to the FCC filing true-up amounts (Exhibit XX). We noted that for SPIN 143002559, Penasco Valley Tel, there was a difference of \$19 between the true-up amount and the amount per the FCC filing and for SPIN 143002238, Kadoka Telephone Company, there was a difference of \$45,749.
41. For the LSS incumbent carriers selected, we ascertained their competitors (Exhibit XXI). We obtained the effective date of the competitor's ETC designation order and ascertained that the carrier was designated as an ETC prior to receiving support. We inspected the annual state certification for timeliness (due 10/1/02) and ascertained whether the competitor's ETC

designation order was granted at a level different than the incumbent, noting no exceptions.

42. For LSS incumbent ETCs, we obtained from NECA (in its role as USAC's vendor) line count data projected as of December 31, 2002, that was filed on October 1, 2002 and support payment disbursed in the second quarter 2003.
43. For LSS competitive ETCs, we obtained from NECA (in its role as USAC's vendor) line count data submitted as of June 30, 2002, that was filed on December 30, 2002 and support payment disbursed in the second quarter 2003.
44. We recalculated the incumbent and competitive ETCs' support received in the second quarter 2003 and noted that it was in agreement with applicable FCC rules. We ascertained that the carriers' support amounts were computed based on the disaggregation path selected. We compared the recalculation to the NECA detailed disbursement authorization, noting no exceptions.
45. We randomly selected May 2003 and inspected the disbursement authorization for adequate review by management.
 - a. We obtained documentation and noted that the SPIN assigned to the carrier to make support payments agreed to the proper study area code for which support was eligible. We noted no exceptions.
46. We obtained from USAC, the October 2000 Projection and the FCC True-Up Filing. The true-up difference is the recalculated true-up amount provided to the incumbent carrier. We then compared the true-up difference to the April 2003 disbursement authorization report, which details the true-up amount actually disbursed to the carriers for the funding year. We noted differences between the true-up amount and the amount per the April 2003 disbursement authorization report for all 5 service providers randomly selected – Brindlee, SPIN # 143001536, Greetingsville Telephone Company, SPIN # 43001736, Century Tel Midwest, SPIN #143001690, Panasco Valley Tel, SPIN #143002559 and Kadoka Telephone Company, SPIN #143002238 (Exhibit XX).

Interstate Access Support

47. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure that input data items are complete and reasonable. We inquired of management and were informed that only authorized input is accepted for processing.
48. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure that only one data submission is processed for each cost company. We inquired of management and were informed that no changes are made to an ETCs high cost data submission without the proper documentation and authorization.
49. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure the ETCs high cost data is reasonable in relation to the ETCs historical data and expected results.
50. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure a post-processing review of high cost data is performed in accordance with management criteria. We inquired of management and were informed that a post-processing review is performed.
51. For those carriers selected in 4 above that are receiving IAS, we obtained the carrier's 2002 Common Line Marketing Transitional (CMT) revenue amount submitted to NECA (in its role as USAC's vendor).
52. For the IAS incumbent carriers selected, we ascertained their competitors (Exhibit XXII) and obtained the effective date of the competitor's ETC designation order and ascertained that the carrier was designated as an ETC prior to receiving support. We inspected the annual self certification for timeliness (due 6/30/02) and ascertained whether the competitor's ETC designation order was granted at a level different than the incumbent, noting no exceptions.
53. For both incumbent and competitive ETCs receiving IAS, we obtained from NECA (in its role as USAC's vendor) line count data submitted for the period ended September 30, 2002, that was filed by December 31, 2002 and support payment disbursed in the first quarter 2003.
54. We recalculated the incumbent and competitive ETCs' support received in the first quarter 2003 and ascertained that it was in agreement with

applicable FCC rules. We compared the recalculation to the NECA detailed disbursement authorization and noted no exceptions.

55. We randomly selected February 2003 and inspected the disbursement authorization for adequate review by management.
 - a. We obtained documentation ascertained that the SPIN assigned to the carrier to make support payments agreed to the proper study area code for which support was eligible. We noted no exceptions.

Interstate Common Line Support

56. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure that input data items are complete and reasonable. We inquired of management and were informed that only authorized input is accepted for processing.
57. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure that only one data submission is processed for each cost company. We inquired of management and were informed that no changes are made to an ETCs high cost data submission without the proper documentation and authorization.
58. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure the ETCs high cost data is reasonable in relation to the ETCs historical data and expected results.
59. We inquired of management the procedures and controls in place and obtained copies of the policies and procedures USAC and its vendors have to ensure a post-processing review of high cost data is performed in accordance with management criteria. We inquired of management and were informed that a post-processing review is performed.
60. For those carriers selected in 4 above that are receiving ICLS, we inspected revenue data provided by Rhoads & Sinon covering July 1, 2002 to June 30, 2003. We noted that ICLS is the difference between the Common Line Revenue Requirement ("CLRR") and other High Cost components, such as Multi-line Business Subscriber Revenue, given to the carrier. The revenue report details each component of support. We ascertained that the difference between the total of these High Cost amounts and the CLRR equaled ICLS. We noted no exceptions.

61. For the ICLS incumbent carriers selected, we ascertained their competitors (Exhibit XXIII) and obtained the effective date of the competitor's ETC designation order and ascertained that the carrier was designated as an ETC prior to receiving support. We inspected the annual self certification for timeliness (due 6/30/02) and ascertained whether the competitor's ETC designation order was granted at a level different than the incumbent, noting no exceptions.
62. For incumbent ETCs receiving ICLS, we obtained from Rhoads & Sinon (in its role as USAC's vendor) line count data submitted as of December 31, 2001, that was filed by July 31, 2002 for support payment disbursed in the second quarter 2003.
63. For competitive ETCs receiving ICLS, we obtained from Rhoads & Sinon (in its role as USAC's vendor) line count data submitted as of June 30, 2002, that was filed by December 30, 2002 for support payment disbursed in the second quarter 2003.
64. We recalculated the incumbent and competitive ETCs' support received in the second quarter 2003 and noted that it was in agreement with applicable FCC rules (Exhibit XXIII). We agreed that the carrier's support amount was computed based on the disaggregation path selected. We compared the recalculation to the NECA detailed disbursement authorization, noting no exceptions.
65. We randomly selected April 2003 and inspected the disbursement authorization for adequate review by management.
 - a. We obtained documentation and ascertained that the SPIN assigned to the carrier to make support payments agreed to the proper study area code for which support was eligible. We noted no exceptions.

LOW INCOME SUPPORT MECHANISM

1. We inquired of and obtained copies of the policies and procedures in place used by NECA and USAC for administering the low income support mechanism.
2. In order to ascertain the Form 497s for July 2003 submitted to USAC from the local exchange carriers and Competitive (CETC) are reviewed for errors, omissions, mathematical errors, accuracy and reasonableness, and input into the system correctly, we obtained the Low Income Disbursement Report for the nine month period ended September 30, 2003, and selected a representative random sample of 45 carriers (all carrier types are represented

in the sample) (Exhibit XXIV). We performed the following procedures:

- a. We proved the arithmetic accuracy of the August disbursement report that corresponds to the sample period from which we selected our sample of 45 carriers.
 - b. We agreed each disbursed amount (Lifeline, Link-up, and Toll Limitation Services) to the Form 497 submitted to USAC or NECA by the carrier. We noted 1 exception. Midwest Wireless, SPIN # 14300271, reported actual support of \$483 on the Form 497 for July compared to actual total support for this carrier of \$463, a discrepancy of \$20.
 - c. We proved the arithmetic accuracy of the Form 497s and ascertained they were complete, noting no exceptions.
 - d. We ascertained that a certification statement, signed by an officer of the company, existed for each carrier.
 - e. We agreed each monthly federal lifeline support amount claimed per subscriber to the low-income state tables detailing the range of data acceptable for this line item for each state and ascertained that the amount was within range.
 - f. We ascertained that each link-up charge waived per connection line item did not exceed the FCC limit of one half of the connection charge or \$30.
 - g. We ascertained that each local exchange carrier and CETC was an ETC by tracing the company to the Eligible Carrier Status Database.
3. In order to ascertain the monthly disbursements from the Low Income Mechanism are properly authorized and accurate, we obtained the disbursement authorization reports for September 2003 and performed the following:
- a. We obtained the Low Income ETC Monthly Projection Algorithm for August 2003 for the carriers selected and proved the arithmetic accuracy of the algorithm.
 - b. We read the monthly projections and agreed the method of calculating support based on Lifeline, Link-up, TLS by tracing these amounts to the total support calculated. We also clerically reviewed the projection for details such as SPIN, SPIN name, and serving area. We obtained the monthly projections and ascertained that the projections were trued-up properly for the carriers selected. We compared any differences

between the projections and the Form 497s submitted by the carriers, and agreed this difference to the actual amount per the latest ‘view screen’ from the database. We noted no exceptions.

- c. We agreed the trued-up disbursement amounts to the Low Income Control Report, noting no exceptions.
 - d. We agreed the total amount of Low Income support for August to the accounts payable control report, and individual payments for selected carriers to check copies for non-pooled members, or transfers and a bank statement for pooled members. We noted no exceptions.
- 4. We inquired of management the controls in place to ensure that one and only one data collection form is processed for each active ETC on the Exchange Carrier Master File (ECMF). We obtained copies of the policies and procedures used to prevent duplication disbursements. For each carrier selected in 2 above, we ascertained that no duplication of payment existed by observing the detailed payment information for July 2003 in the Low Income database. We noted no exceptions.
 - 5. We obtained a list of carriers that had not submitted a Form 497 in the last 6 months, at the date of testing (Exhibit XXV). We inspected projections and ascertained that no carrier in the sample selected in 2 above had received disbursements based on projections more than 6 months old.

RURAL HEALTH CARE SUPPORT MECHANISM

General

- 1. We met with the Rural Health Care Administrator (“USAC RHC” or “NECA”) of the Rural Health Care Support Mechanism (“RHCSM” or “RHC Mechanism”) and discussed the critical processes related to the overall administration of the RHC mechanism. In addition:
 - a. We inquired of USAC RHC the procedures and key controls in place pertaining to the receipt and processing of RHCSM Funding Year 2003 applications and Funding Year 2002 invoices and documented the discussion in the form of process maps (Exhibit XXVI).
 - b. We also obtained and read USAC’s organizational charts including outsourced functions.
 - c. We obtained a list of key personnel.

Understanding the Business

2. In order to gain a detailed understanding of each of the processes, we performed the following:
 - a. We met with the USAC RHC process owners for each function or business process and discussed with them the controls and procedures pertaining to the overall administration of the RHCSM, which included the receipt, approval and processing of applications, invoices, and other applicable support mechanism related processes.
 - b. We observed the process flow for each component process contained within the RHCSM related activities and applicable FCC forms including the following areas:
 - Application process
 - FCC Form 465 (Health Care Providers Universal Service - Description of Services Requested and Certification Form)
 - FCC Form 466 (Health Care Providers Universal Service - Funding Request and Certification Form)
 - FCC Form 466-A (Health Care Providers Universal Service – Services Ordered and Certification Form)
 - FCC Form 467 (Health Care Providers Universal Service – Receipt of Service Confirmation Form)
 - FCC Form 468 (Health Care Providers Universal Service - Telecommunication Service Provider Form)
 - Appeals
 - Fund Management and FCC Reporting (including FCC rules changes review and implementation)
 - Invoices and support payments (credits) processing for RHC Manual Telecommunications Carrier Invoices
3. We obtained copies of the written USAC policies and procedures covering the RHCSM and inquired if there was a process in place to provide reasonable assurance that they were in compliance, as applicable, with the FCC's Universal Service Rules and Regulations that apply to the RHCSM. We were informed that the USAC policies and procedures were in accordance with the Universal Service Rules and Regulations.

Application Sample Selection

4. For Funding Year 2003, we obtained a data file of all Funding Year 2003 approved applications as of September 30, 2003 (the selection date).
5. We sorted and totaled the count and cumulative funding value of the applications contained within the Year 2003 data file and compared the totals to the system database totals for Funding Year 2003, without exception.
6. We selected the 10 applications with the highest dollar values, representing 73% of the total value of Year 2003 applications included in our population. We randomly selected an additional 15 applications from the remaining population. The aggregate funding amount for our total sample selection of 25 applications was approximately \$353,000 (see Exhibit XXIX).
7. For each application selected in step 6 above, we obtained the FCC Forms 465, 466, 466-A, 467 and 468 and agreed, as applicable, the Health Care Provider (“HCP”) name, number, address and work order number on each form to the corresponding information contained in the Year 2003 data file, without exception.

Application Process

8. We compared and agreed the funding amount per the data file for each application selected to the approved funding amount per the corresponding Funding Commitment Letter, noting no exceptions.
9. We obtained the procedures in place to provide reasonable assurance that FCC Forms 465 received are inspected timely for errors and omissions and we calculated for each of the selected applications, the number of days between the receipt date of the corresponding Form 465 to the posting date per the corresponding HCP Posting letter, noting no exceptions.
10. We inquired of USAC RHC the controls in place which ensure that HCPs requesting support are ascertained to be eligible HCPs, and performed the following procedures for each application selected:

We recalculated the Maximum Allowable Distance (“MAD”) for eligible HCPs, using “Street Atlas 5.0” (the commercial software package used by USAC for this purpose) and noted 13 instances with allowable differences of 2 miles or less, and no differences in the remaining 12 support amounts in the sample. No exceptions noted.

Using USAC’s Intranet, we ascertained, without exception, that each of the applicants selected was located in an eligible rural area.

11. We inquired of and observed the process in place to determine the eligibility of HCPs pursuant to the criteria in Section 54.601, such as public or not for profit entity. We observed the completion of the applicant self-certification indicating that they are eligible pursuant to the criteria set forth in Section 54.601.
12. We inquired of and observed controls which ensure that USAC RHC has observed that the telecommunication carriers providing services under the RHCSM are on the Telco SPIN list of the Rural Health Care Division.
13. We inquired of and observed controls that provide reasonable assurance that the HCPs receiving support adhered to competitive bidding requirements in accordance with FCC Rules and Regulations, as follows:
 - a. We ascertained, through inquiry and observation, that procedures were in place to document the date that the application was posted to the RHCSM web site (the "posting date"), which commences the 28-day Request for Proposal ("RFP") posting requirement.
 - b. We obtained and inspected the RHCSM policies and procedures pertaining to the verification of application funding requests and the determination of the need for competitive bidding for existing, as opposed to new services.

For each of the 25 applications selected in step 6 above, we noted compliance with the applicable requirements through inquiry, observation and completion of the following steps:

- c. We observed that an original signed copy of the corresponding Form 465 was received and retained prior to allowing an HCP post on the web site.
- d. We noted compliance with the 28-day RFP posting requirement by agreeing the posting date per the supporting Packet Review Checklist to the web site posting date, noting no exceptions.
- e. Of the 25 selected applications, 15 applicants had an existing tele-communications carrier contract. Upon inspection of the HCP's approval and support calculation worksheet, we observed that the HCP was included on the Evergreen Contracts List. We were informed by NECA that this is a worksheet that includes all approved HCP's with an existing contract, thereby excluding them from the competitive bidding process. We noted no exceptions.
- f. We noted, without exception, that the service start date, as indicated on the Form 467, was outside of the 28-day competitive bidding period, by agreement of the Form 467 service date to the eligible start date per the web site posting.

g. We noted, without exception, completion of the applicable Form 466 Block 9: Certification.

h. We noted that either an original signed copy or an e-certification of the corresponding Form 465 was received and retained on file prior to the posting of the application to the web site. We agreed the service date on the approved Form 465 to the posting date per the supporting Packet Review Checklist, noting no exceptions.

i. For 15 of the 25 selections, we could not ascertain the support date used to generate the Support Schedule is the latter of the Service Start Date given by the carrier on Form 467 and the Eligible Support Start Date on the Funding Commitment Letter, as NECA had not received the Form 467s from the HCP at the date of our testing and the support schedules were not available. For the remaining 10 selections, we obtained the support schedules and noted that the start date used to generate the schedule was the latter of the Service Start Date given by the HCP on the Form 467, or the Eligible Support Start Date given on the Funding Commitment Letter, noting no exceptions.

14. We inquired of and observed controls which ensure that the method used to calculate support is in accordance with FCC Rules and Regulations, as follows:

a. For the 5 highest dollar applications committed for funding, we recalculated and agreed the support amount per the applicable Form 468 worksheet, and ascertained that the calculation was performed in accordance with FCC requirements.

b. For each of the 5 applications selected in step a. above, we agreed the support amount as indicated on the supporting Form 468 worksheet to the approved Funding Commitment Letter, noting no exceptions.

15. We noted the type of service requested and approved in each of the 25 applications selected in step 6 above per the Funding Commitment Letter, and noted, without exception, the eligibility of approved (tele-communication) services by agreement to the eligible services listed on the RHCSM web site.

Telecommunication Carrier Invoices

16. We inquired of USAC RHC the controls pertaining to the receipt and processing of telecommunication carrier invoices and application of support payments (credits). We performed the procedures in Rural Health Care steps 20 through 22 below pertaining to the receipt and payment of telecommunication carrier invoices.

17. We obtained a data file from USAC RHC of specified information (i.e., work order number, telecommunication carrier name and SPIN, invoice number, and amount) pertaining to all Funding Year 2002 invoice line items processed as of September 30, 2003. We selected a random sample of 45 invoice line items (see step 19 below) for inspection. The total population of invoice line items from which our sample was selected consisted of 378 line items totaling \$16.23 million.
18. We sorted and totaled the number of invoice line items (378) and total dollar value (\$16.23 million) of Year 2002 invoices contained within the data file and compared the totals to the system database totals, noting no exceptions.
19. We used a randomly selected a sample (from the population of 378 invoice line items) of 45 invoice line items. The aggregate funding amount for our total sample selection of 45 invoice line items was approximately \$236,000 (see Exhibit XXX).
20. For each of the 45 items selected in 17 above, we obtained and agreed the telecommunication carrier name and SPIN per the corresponding telecommunication carrier invoice and approved HCP Funding Commitment Letter to the data file, noting no exceptions.
21. For the 45 items selected in 17 above, we inquired of and observed controls that invoices from telecommunication carriers agree to, and do not exceed, forecasted support amounts as follows:
 - a. We compared the month and amount of the approved line item selected to the corresponding HCP Application Support Schedule and noted, without exception, that the line item amount did not exceed the approved “support amount” for the same month per the Support Schedule.
 - b. We compared and agreed the line item amount to the corresponding approved line item amount in the SID, without exception.
 - c. We obtained and read the corresponding Invoice Review Checklists for completeness of information required, noting no exceptions.
22. For each of the 45 telecommunication carrier invoices selected in 17 above, we performed the following:
 - a. We agreed the Billed Telephone Number to the HCP Support Schedule, without exception.
 - b. We compared the invoice header and line item information to the corresponding information in the SID, without exception.

- c. We agreed the invoice amount per the RHCSM Manual Telecommunications Carrier Invoice to the RHCSM Invoice Reconciliation, without exception.
- d. We totaled and agreed the total line items included on the invoice to the invoice total, without exception.
- e. We identified the line items denied on the invoices selected and noted that a denial reason code was indicated on the Supporting Invoice Review Checklist.
- f. We noted that invoices were approved for payment by agreement to the Approved Support File sent to the USAC Billing department, without exception.
- g. We observed that the invoice amounts submitted to the USAC Billing department for payment processing agreed to the amount payable to the telecommunication carriers, by comparing the invoice amount to the corresponding credit posted to the telecommunication carrier's Universal Service account, noting no exceptions. For the period ended September 30, 2003, we noted a difference between the total disbursements per the USAC G/L and the total RHC approved amount as follows:

Total disbursements per USAC G/L	\$16,229,782.03
Total RHC approved payments for 2002	<u>\$16,229,755.56</u>
Difference	<u>\$ 26.47</u>

We were informed that the difference was due to a bankruptcy court ruling. The court ruled that USAC should return a portion of a carrier payment. This amount was allocated across all the support mechanisms.

- 23. We inquired of, observed and obtained copies of the policies and procedures related to the process by which USAC RHC processes and approves the return of funds from service providers, including the restoration of funding caps and the role of the USAC Billing and Disbursement department in the receipt and recording of returned funds.

Fund Management/Performance in Accordance with Available Funds

- 24. We inquired of, observed, and obtained copies of the policies and procedures related to controls which ensure that the support mechanism-funding cap is not exceeded.
- 25. We were informed that USAC is required to submit quarterly projections of projected demand to the FCC. We inquired as to the method used to determine required demand projections.

Outreach, Public Education, and Web Site

26. We inquired of, observed, and obtained copies of the policies and procedures related to the outreach and public education efforts for Fund Year 2003 and the plans for the future. We also inquired as to and observed the existence and contents of the outreach web site.

Rule Changes

27. We inquired of, observed, and obtained copies of the policies and procedures related to the process used by USAC RHC which ensures that all FCC rule changes are identified, documented and incorporated into the RHCSM funding process.

Appeals

28. We inquired of, observed, and obtained copies of the policies and procedures related to the process by which USAC RHC handles appeals from applicants pertaining to fund commitment adjustments and funding request denials.
29. We randomly selected 10 appeals (Exhibit XXXI) (all 10 pertaining to Funding Year 2002) from the appeals log, and performed the following:
 - a. We obtained the application folders for each appeal selected and agreed the HCP name and appeal date from the appeals log to the folder. We noted one exception in Appeal # UO2-6-1, HCP # 11064, Iliuliuk Health and Family Services. The HCP number within the data file was different from the HCP number in the applications folder. We inquired of management and were informed that this was a manual error that was corrected in the ordinary course of business.
 - b. We compared the date received on the appeal correspondence to the date of the Funding Commitment Letter and noted that the appeals were received within the 30 or 60-day appeal window, as applicable, without exception.
 - c. We noted the reasons for the applicant's appeal and obtained the underlying documentation supporting the appeal noting that the appeals were approved or denied in accordance with FCC Support Mechanism guidelines (e.g., eligible services, eligible service providers, discount calculations).

Other

30. We inquired whether USAC and/or the Rural Health Care Committee had authorized any internal (or other) audits of RHCSM recipients of universal service support (Section 54.705(b) (1) (viii)) from January 1, 2003 to December 31, 2003. We were informed that USAC Internal Audit had

performed no internal audits of RHCSM recipients of universal support during this period.

SCHOOLS AND LIBRARIES SUPPORT MECHANISM

General Procedures

1. We met with USAC management of the Schools and Libraries Support Mechanism (“SLSM” or the “S&L Support Mechanism”) and members of the Schools and Libraries Administrative Division (“USAC SLD”) and discussed the critical processes related to the overall administration of the “S&L” Support Mechanism. We obtained copies of the SLSM policies and procedures. In addition:
 - a. We inquired and were informed that SLSM is in the Funding Year 2003 application period that covers the period from July 1, 2003 through June 30, 2004.
 - b. We inquired of USAC SLD process owners the procedures and key control points pertaining to the receipt and processing of SLSM Funding Year 2003 applications and Funding Year 2002 invoices and noted the procedures in the form of process maps (Exhibit XXXII).
 - c. We also obtained and read USAC and USAC SLD key personnel lists and organization charts, as well as those pertaining to functions outsourced to Pearson Government Solutions in Lawrence, Kansas.

Understanding the Business

2. We performed the following:
 - a. We met with USAC SLD process owners for each function or business process and discussed with them the controls and procedures pertaining to the overall administration of the S&L Support Mechanism, which included the receipt, approval and processing of applications; the receipt, approval and payment of Billed Entity Application Reimbursements (“BEAR”) or Service Provider Invoices (“SPI”) for which funding has been previously approved through the S&L Support Mechanism funding process; and other applicable SLSM processes.
 - b. We observed each process contained within the SLSM activities and applicable FCC forms including the following:

Application processes:

- FCC Form 470 (Schools and Libraries Universal Service - Description of Services Requested and Certification Form)

- FCC Form 471 (Schools and Libraries Universal Service - Ordered and Certification Form)
- Entity Block 4 and Modification Process
- Site identifier correction process
- Service substitution process

Appeals

Commitment adjustments

Returned funds, including the recovery of erroneously disbursed funds

Fund Management and FCC Reporting (including FCC Rule changes review and implementation)

Invoice and support payments (credits) processing

- FCC Form 486 (Schools and Libraries Universal Service - Program Receipt of Service Confirmation Form)
- FCC Form 472 (Billed Entity Application Reimbursement Form)
- FCC Form 474 (Service Provider Invoice Form)
- FCC Form 500 (Adjustment to Funding Commitment and Modification to Receipt of Service Confirmation Form)
- Service Provider Identification Number ("SPIN") Changes
- Invoice deadline exception request

c. We used the information obtained from our observations in step 2 to assist in performing the SLSM agreed-upon procedures steps 4 through 54.

3. We inquired of USAC SLD personnel the process in place to monitor compliance with the FCC's Universal Service Rules and Regulations governing SLSM. We obtained and read a matrix prepared by USAC SLD personnel that compares the FCC Universal Service Rules and Regulations and amendments for SLSM to the written SLD policies and procedures.

Controls over Preliminary Application and Invoice Processing – Subcontractor (Pearson Government Solutions) Review

4. We visited the Pearson Government Solutions facility and inquired and observed the procedures and controls in place relating to the initial receipt and preliminary processing of applications and invoices. We performed the following:
 - a. We inquired of Pearson Government Solutions personnel the controls in place pertaining to the receipt of funding applications to provide reasonable assurance that applications received during the filing "window"

were identified, prioritized and segregated for funding purposes from applications received outside the filing “window”. We were informed that physical security and safeguards of the HeadsDown, PIN, and Online Forms Development systems located at Pearson Government Solutions in Lawrence, Kansas are in existence.

- b. We observed the procedures and controls in place pertaining to the receipt of applications and invoices, including BEARs and SPIs, and the tracking procedures utilized by Pearson Government Solutions to ensure that all applications and invoices received were tracked, scanned and data entered into the system in accordance with approved procedures.

Application Sample Selection

5. We obtained a data file from USAC SLD of specified information (i.e., fund year, billed entity number, applicant name, applicant category, state, application number, application status, application PIA status, funding request number (“FRN”), estimated annual cost, request amount, committed amount, committed date, wave number, service ID, discount percentage, SPIN, service provider, contract number and service start date) pertaining to Funding Year 2003 applications processed from April 22, 2003 (the first funding wave) through November 10, 2003, the selection date. A random sample of 55 Year 2003 applications was selected utilizing the statistical sampling parameters as defined in step 7 below. The total population from which the sample was selected contained 28,690 applications with a total funding value of \$1.25 billion.
6. We sorted and totaled the number and cumulative funding value of the applications contained within the application data file and agreed the totals (28,690 applications and \$1.25 billion) to the system database totals, noting no exceptions.
7. We summarized the file by application number and sorted the data from highest to lowest by application funding amount. We extracted the ten applications with the highest dollar value, representing 13% of the total value of Funding Year 2003 applications included in the population. In addition, we calculated a sample size using a confidence level of 90% and a planned precision rate of 5% and randomly selected an additional 45 applications from the total remaining population of 28,680 applications. The aggregate funding amount for the sample selection of 55 applications was \$163.1 million (Exhibit XXXIII).
8. We obtained a database of 4,460 applications, totaling approximately \$345.6 million, processed after November 10, 2003 (the selection date as described in step 5 above) through December 12, 2003. We noted that the 4,460 applications processed from November 10, 2003 through December 12, 2003 represented 21.6% of Funding Year 2003 applications processed from April 22, 2003 through December 12, 2003. From this database, an additional 2 applications with the highest dollar value were selected, totaling \$150,869,821 (Exhibit XXXIII). We inspected these 2 applications and noted that they were eligible entities, the applicants were CIPA compliant, the services they requested were eligible

- services, and that their discount percentage was within the acceptable threshold, which was 90% for internal connections. We noted no exceptions.
9. We inquired of USAC SLD management as to whether the SLSM system is designed with controls that recognize and identify applications that do not meet certain pre-programmed criteria contained within the SLSM system. We were informed that these controls exist.
 10. Using the file obtained in step 5 above, we extracted all FRNs pertaining to the 55 applications selected in step 7 above and agreed the total funding value of the extracted FRNs to the total funding value of the selected applications.
 11. From the 290 FRNs contained within the population of 55 selected applications, we selected a sample of FRNs as follows:
 - a. From each of the 55 selected applications, we selected the FRN with the highest dollar value for that application. The aggregate value of the 55 FRNs selected amounted to \$77.9 million, representing 47.7% of the \$163.1 million associated with the 55 selected applications.
 - b. We randomly selected an additional 25 approved FRNs from the remaining 235 FRNs associated with the 55 selected applications, for a total sample size of 80 FRNs.
 12. We obtained from USAC SLD personnel a data file of the application Block 4 (Discount Calculation Worksheet) data. We ascertained the completeness of the Block 4 data file by agreeing the total number of records contained in the data file to the total number of records contained in the SLD Oracle system.

Ensuring That Only Eligible Entities Receive Program Support

13. We obtained a copy of the PIA manual and noted the procedures that ensure that only schools and libraries that meet the definition of eligibility pursuant to applicable FCC regulations obtain funding through the SLSM.
14. We obtained a copy of the Requesting Organization SLC ("ROS") database maintained by the USAC SLD. The information contained in the database included data on the number of students eligible to participate in the National School Lunch Program. We agreed the number of records in the copy of the ROS data file to the number of records in the ROS system database maintained by the USAC SLD process owner, noting no exceptions.
15. We compared and agreed the entity name and number in our copy of the ROS data file as of the date of the application approval to the Block 4 database obtained from the USAC SLD process owner, noting no exceptions.
16. We inspected each of the 55 selected applications referred to in step 7, including any notes posted in the USAC SLD process owners Simplified Tracking Application Review System ("STARS") which supported the modifications. We observed that none of the funding amounts for the 55 applications selected in step

7 had been modified (reduced) due to the identification of ineligible entities by PIA. We also obtained a data file that listed all applications in Funding Year 2003 with modified funding amounts due to the identification by the PIA of ineligible entities. From this file, a sample of 5 applications (Exhibit XXXIV) were randomly selected and we performed the following:

- a. We inquired as to the rationale by which USAC SLD determined the entity to be ineligible and were informed that they maintained records to support their decision.
 - b. We agreed the funding request and funding commitment amounts for each of the FRNs associated with the identified modified applications to the funding commitment display or the Funding Commitment Letter, noting no exceptions.
 - c. We recalculated and agreed the approved dollar amounts to the Funding Commitment Display, without exception, as follows:
 - i. If the dollars associated with the ineligible entity were identified, we ascertained, without exception, that the identified dollar amount was appropriately applied to reduce or deny the FRN; or
 - ii. If the dollars associated with the ineligible entity were not identified, we recalculated the enrollment percentage applied to the FRN amount and ascertained, without exception, that the correct dollar amounts were applied to reduce or deny the FRN.
17. For each of the FRNs associated with the 5 applications selected in step 16 above, we performed the following:
- a. For FRNs in which the dollars associated with ineligible entities were less than 30% of the total dollars requested for that FRN, we noted that the FRN was appropriately reduced by the dollar amounts associated with the ineligible entity, without exception.
 - b. We ascertained without exception that the balance of the FRN containing discounts for eligible entities remained eligible to receive funding commitments.
 - c. We ascertained without exception that none of the applications selected per step 16 above had dollars associated with ineligible entities greater than 30% of the total dollars requested for that FRN.
 - d. We ascertained without exception that none of the applications selected per step 16 above had dollars associated with ineligible entities resulting in a potential modification amount of less than \$50.

Discount Percentages Comply with FCC Criteria

18. We obtained a copy of the PIA manual and noted that it contains procedures that require the USAC SLD process owners to consider, in accordance with FCC

regulations, the level of economic disadvantage of the school, school district, or school district where a library resides, and whether a school or library operates in an urban or rural location when determining program eligibility.

19. We inquired of USAC SLD process owners and were informed that requests for discounts on telecommunications and internet services receive funding commitments as first priority followed by second priority requests for internal connections.
 - a. We inspected the FRNs in the data file obtained in step 11 above and ascertained that FRNs with internal connections and with a discount percentage below 80% were denied due to the funding cap. We noted no exceptions.
 - b. We inquired of USAC SLD process owners and obtained copies of the controls in place which ensure that all applications for internal connections with a discount percentage below 80% are denied. We were informed that this objective is not addressed in the PIA manual, but it is a rule of the program. We were further informed that requests for priority one (telecommunications and internet services) receive funding commitments followed by requests for internal connections, which are second priority.
20. We used the sample of 55 FRNs selected in step 11a above and performed the following:
 - a. We obtained the discount calculation formula for each entity included in the 55 selected FRNs and recalculated the level of economic disadvantage based on the percentage of students eligible to participate in the National School Lunch Program as indicated in the Block 4 data file. No exceptions were noted.
 - b. We noted that each entity included in the 55 selected FRNs determined their level of economic disadvantage based on the percentage of students eligible to participate in the National School Lunch Program. We inquired of USAC SLD process owners the procedures and guidelines in place for those applicants choosing a federally approved economic disadvantage level measure other than the National School Lunch Program. We were informed that these procedures and guidelines are posted on the SLD web site and that, while all selected FRNs' discounts were determined using the National School Lunch Program, there are FRNs where the discount is determined through approved alternative discount measures.
 - c. We compared the designation of rural or urban for 9 of the 55 applications included in the selected FRNs to information contained within the Block 4 data file, noting agreement. However, as a determination of the rural or urban designation may only be made at the detailed entity level, we were unable to agree the remaining 46 application selections because they were either a school district, library or consortium consisting of a number of entities.

- d. We randomly selected a sub-sample of 20 (Exhibit XXXV) of the 55 selected FRNs and agreed the discount percentage per the FRN to the discount percentage per the SLD Discount Matrix, noting no exceptions.

Program Support Is Committed Only for Eligible Services

- 21. We used the combined sample of 80 FRN line items selected in steps 11a and 11b above, and inspected each FRN line item noting, without exception, that, if the applicant had requested support for telecommunications services or Internet access and the FRN was found to contain any requests for support for internal connections, the FRN was reclassified by USAC SLD process owners as internal connection services and designated as second priority. For each of the 80 selected FRNs, we noted, without exception, that first priority contained requests for discounts relating to telecommunications services and Internet access and second priority contained request for discounts for internal connections. In addition, we performed the following:
 - a. We selected a sub-sample of 25 FRNs (Exhibit XXXVI) from the population of 80 FRNs. For each of the selected FRNs, we noted that only the specific services as indicated on the eligible service database relating to the FRN category were included, without exception.
 - b. We compared and agreed the service category and funding amount per each selected FRN to the approved service category and funding amount per the corresponding Funding Commitment Letter or display (the online version of the printed data including in the Funding Commitment Letter), noting no exceptions.
 - c. We noted, by inspecting the STARS review notes for each FRN selected, that services were appropriately classified or reclassified, as applicable, without exception.
 - d. We obtained a copy of the PIA manual and noted that it described the procedures pertaining to eligible services. We noted compliance with these procedures for the selected sample of 80 FRNs in steps 11a and 11b above through completion of steps 21a to 21c above.
- 22. We inquired as to the procedures employed for updating and tracking changes made to the Eligible Service and Products (“ESP”) database. We inspected the supporting documentation provided by USAC SLD process personnel which included history reports and word documents observing that the tracking system located within the database captured and tracked changes to the ESP database.
- 23. We inquired of USAC SLD process owners whether training was provided to PIA staff covering eligible services and were informed that the training was provided and covered what services are eligible and how to access the list of eligible services. In addition, we obtained a copy of the PIA training manual and noted that it included training on eligible services.

24. We inquired of, observed, and obtained copies of the procedures and controls in place which ensure, where USAC SLD has determined that certain services are conditionally eligible for funding, that such services are used only for the purposes set forth by SLD in the eligible services matrix on the USAC web site and that support mechanism funding is committed only for eligible services. For each of the FRNs selected in step 21a above we compared and agreed each service receiving funding to the eligible service list.
25. We obtained a copy of the PIA manual and noted that it described the procedures pertaining to commitment of support only for eligible services.
26. We inquired of USAC SLD and observed the procedures and controls in place to ensure that: 1) FRNs which, upon inspection by USAC SLD, are found to contain less than 30% of ineligible services are adjusted to eliminate the ineligible services from the funding request, and 2) FRNs which, upon inspection by USAC SLD, are found to contain 30% or more ineligible services are denied in their entirety.
 - a. We compared and agreed the funding request and approved funding amounts for each of the selected sample of 80 FRNs in steps 11a and 11b above and noted that none of the selected FRNs had been modified. In addition, we obtained a query that identified all FRNs that had been modified for ineligible services and whose modifications were less than 30%. We randomly selected 45 FRNs (Exhibit XXXVII) and recalculated the percentage change between the funding request and committed amount and ascertained, without exception, that the modified amount was less than 30%. We noted that the FRN amount had been appropriately adjusted by comparison of the approved amount to the amount per the funding commitment display, noting no exceptions.
 - b. We performed the following:
 - i. From the 290 FRNs included within the 55 applications selected in step 11 above, we identified all denied FRNs with a zero dollar committed amount. We noted that none of the FRNs associated with our applications sample had FRNs that were denied. In addition, we obtained a database from USAC SLD representing all FRNs that were denied to date due to ineligible services from the entire population of applications. From the 2,750 denied FRNs, we selected a random sample of 20 denied FRNs (Exhibit XXXVII).
 - ii. For each of the 20 FRNs selected and denied due to ineligible services, we obtained the initial funding request, and noted the ineligibility of the service requested by comparing them to the eligible services found on the ESP database.
 - iii. For each of the 20 denied FRNs selected, we recalculated the percentage of ineligible services to the total funds requested and compared the percentage calculated to the supporting schedules and calculations

provided by USAC SLD, and noted one exception. For FRN #986526, we inspected the supporting documentation and noted the FRN was improperly denied for support. However, we were informed by USAC SLD that this FRN was appealed and the appeal will be granted.

- c. We obtained a copy of the PIA manual and noted that it describes the procedures pertaining to FRN denial.
27. We inquired of USAC SLD process owners the Funding Year 2003 procedures for processing service substitutions, and performed the following:
- a. We obtained the service substitution log and randomly selected 10 service substitution applications (Exhibit XXXVIII). We read each service substitution request and noted that the applicant properly submitted a completed request by submitting a letter requesting a service substitution, without exception.
 - b. We obtained the service substitution review and decision form for each of 10 service substitution applications selected and noted the substituted service or equipment resulted in an increase in price and the substituted service category was consistent with the original Form 470 posting and Request for Proposal. We noted one service substitution, for FRN #936777, which resulted in an increase in price. We also noted that the amount originally committed to that FRN did not increase as a result of the increase in price. We were further informed that the FRN was not approved and the service substitution was denied.
 - c. In connection with the originally selected 55 applications, we noted that none had FRNs with service substitutions.

Child Information Protection Act Compliance

28. We inquired of USAC SLD process owners the procedures and controls in place which ensure that the Year 2003 applicants have certified that they have complied with the requirements of the Child Information Protection Act (“CIPA”); or that they are undertaking actions including necessary procurement procedures to comply with the requirements of CIPA; or that CIPA does not apply to them because they are receiving discounts for telecommunication services only and were informed such procedures are in place.
29. For each of the 55 applicants selected in step 7 we obtained a copy of the Form 486 (Receipt of Service Confirmation Form) and inspected it for completion of the block certification compliance requirements with CIPA. To ascertain 2002 disbursements have been approved without the CIPA certification for the fund year 2002, we inspected a sample of 45 invoices paid through December 12, 2003, noting without exception the invoices for internet services and internal connections were in compliance with CIPA or in the process of becoming compliant.

Vendor Invoices

30. We obtained a data file from USAC SLD containing all Year 2002 invoices processed through the selection date November 10, 2003 and other specified information including: invoice applicant ID, FRN, application number, invoice type, billed entity number, SPIN, service provider name, status of payment, total undiscounted amount and approved (discounted) payment amount, date received and USAC sent dates. A sample of 50 invoice line items (representing 50 service provider invoices) was selected as described in steps 30a and 30b below. The total population of invoice line items from which the sample was selected consisted of 55,604 invoice line items totaling \$1.136 billion. The sample of 50 invoice line items was selected as follows:
- a. We extracted all of the negative line items (319 records, totaling \$1,965,280) pertaining to returned funds contained in the invoice data file.
 - b. We sorted the invoice data from the highest to the lowest approved payment amount and identified the top 5 dollar value invoice line items for part of our sample selection (Exhibit XXXIX).
 - c. We calculated the sample size using a 90% confidence level and a planned precision rate of 5% with no expected errors. We randomly selected an additional sample of 45 invoice line items, totaling \$154,026 from the total remaining population of invoices. The aggregate amount for the total sample selection of 50 invoices was \$74.4 million (Exhibit XXXIX).
31. For each of the 50 invoice line items selected, we obtained the corresponding BEAR or SPI and agreed the invoice dollar amount, FRNs, service provider name, SPIN and application number per the invoice data file to the invoice, noting no exceptions.
32. We agreed each of the 50 invoice line item dollar amounts approved for payment per the SLD Invoice Tracking System to the USAC Remittance Statement created by the approved payment file and sent to the USAC Billing and Disbursement department. We noted no exceptions.
33. We obtained all data files for invoices processed in 2003 and related data described in steps 33a through 33d below from USAC SLD pertaining to Year 2002 invoices through December 12, 2003. We sorted the number of records and totaled the dollar value (as applicable) contained within each of the four data files listed below, and agreed them, without exception, to the corresponding SLD system database totals.
- a. We obtained a data file of all Year 2003 Funding Commitments by FRN (the "Commitment data file"), regardless of funding year. The fields contained in this data file were application name and number, FRN, SPIN, service provider name, approved discount rate, approved funding commitment amount, funding status, and Billed Entity Number ("BEN"). The total population of this data file contained 138,303 line items totaling \$2.2 billion. We noted no exceptions.

- b. We obtained a data file of the Invoice Approved Payment data by FRN (the "Invoice Payment data file"), which was processed in 2003, regardless of funding year. The fields contained in this data file were application name and number, FRN, SPIN, service provider name, BEN, total undiscounted approved payment amount, and total approved (discounted) payment amount. The total population of this data file contained 302,096 FRNs totaling \$1.389 billion approved (discounted) payment amounts. We noted no exceptions.
 - c. We obtained a data file of the Form 486 data for Year 2002 applications (the "Form 486 data file"). The fields contained in this data file were application number, FRN, Form 486 application ID, BEN, SPIN, service provider name, start date, and Pearson Government Solutions receipt date. The total population of this data file was 245,677 records. We noted no exceptions.
 - d. We obtained a data file of Form 500 data processed in 2003, regardless of fund year (the "Form 500 data file"). The fields contained in this data file were application number, FRN, SPIN, service provider name, application ID, commitment amount, revised commitment amount, and received date. The total population of this data file was 8,731 records. We noted no exceptions.
34. For each FRN we compared the sum of the approved (discounted) payment amount per the Invoice Payment data file to the approved funding commitment, per the commitment data file. We noted that for any excess payments identified the amount was properly recorded in the COMAD database. For FRN # 986526, we noted the approved (discounted) payment amount, per the Invoice Payment data file was greater than the committed amount, per the commitment data file. However, we were informed by USAC SLD that this is in accordance with approved procedures as this FRN is in the recovery process.
35. We extracted all FRNs with a positive approved payment amount from the invoice data file and noted that a Form 486 was submitted for each FRN, by comparing the Invoice data file to the Form 486 data file, except for 42 FRNs in the Invoice data file that were not included in the Form 486 data file.
36. We compared FRNs per the Invoice Payment data file to the Form 500 data file noting that FRNs with an approved payment amount greater than zero were not cancelled on the Form 500 data file. We noted no exceptions.
37. We compared the discount percentage for each FRN in the Invoice Payment data file to the approved corresponding FRN discount percentage per the Commitment data file, noting no exceptions.
38. We noted that with the exception of 108 FRNs, all FRNs with approved payment amounts, per the invoice payment data file, were listed as "Committed - Full" per the Commitment data file. We observed that 108 FRNs are in the COMAD system either going through the recovery process or have been successfully recovered by USAC, although 5 of the 108 FRNs are still under investigation.

39. We inquired of USAC SLD process owners the process by which they identify and resolve error codes. We were informed that the identification is an automatic process and resolution is a manual process. For each of the FRNs selected in steps 11a and b with error codes, we read the documentation maintained in the internal tracking system or ISTARs, as well as documentation USAC SLD received from third parties.
40. We inquired of USAC SLD process owners the controls in place which ensure that changes in service provider selections (“SPIN changes”) included applicant certification that: (1) the SPIN change was allowed under its state and local procurement rules; (2) the SPIN change was allowable under the terms of the contract between the applicant and its original service; and (3) the applicant had notified its original service provider of its intent to change service providers, and performed the following:
- a. We inquired of USAC SLD process owners the procedures and controls in place which ensure that the amount of funding available for the new service provider is limited to the amount committed on the FRN less the amount paid to the original service provider. 45 service providers (Exhibit XXXX) with SPIN changes were randomly selected and we noted that additional payments were not made to the new service provider until a SPIN change had been fully processed and recorded in the Oracle system. For application #242088, we were not provided with a SPIN request letter to support the applicant certification.
 - b. We inquired of USAC SLD process owners the procedures and controls in place which ensure that USAC did not make additional payments on the FRN until the SPIN change was reviewed and either (1) approved and the SPIN was changed or (2) denied and that USAC verified that additional invoices were for services actually rendered to the applicant by the original provider. For service providers selected in step 40a, we obtained the SPIN change documentation and noted that no invoices were paid until the SPIN number request was approved. For application #242088, we were not provided with the SPIN change documentation, as we were informed that there has been no SPIN change for this application. Further, we ascertained that no invoices were paid on the FRN.
41. We inquired of USAC SLD process owners the controls instituted to prevent vendors from being paid twice for the same invoice. We entered an invoice into the system that already existed and observed that the system denied processing of the invoice.
42. Excluded from our initial sample selection in step 30 were 9,839 invoice line items totaling \$50.7 million, processed from the selection date of November 10, 2003 through December 12, 2003. 10 invoice line items (Exhibit XXXIX) were randomly selected and we performed the following:

- a. We ascertained, by reading the funding commitment display, that invoice dollar amounts approved for payment, on an FRN basis, did not exceed the funding commitment limits. No exceptions were noted.
- b. We agreed the service provider name, FRN and description per the selected invoice to the approved funding commitment display, without exception.
- c. We agreed each FRN line item amount per the invoice to the corresponding FRN line item amount per the USAC Remittance Statement, noting no exceptions.

Returned Funds

43. We inquired of USAC SLD process owners the process by which USAC SLD receives, documents, processes and approves the return of funds from service providers, including the restoration of funding caps and the USAC Billing and Disbursements department's role in the receipt and recording of returned funds.
44. We obtained an electronic copy of the SLD Returned Fund Log (an Excel spreadsheet) containing all funds returned in 2003. We also obtained an electronic copy of the USAC Returned Fund Log (an Excel spreadsheet) separately maintained by the USAC Billing and Disbursements department.
45. From the SLD and USAC returned funds logs, a sample of 20 FRNs (10 each) (Exhibit XXXXI) were randomly selected and we inspected each FRN noting that the returned funds for the selected FRNs were received, documented and the amounts were restored to the corresponding FRN. We compared and agreed the information recorded in the USAC Billing and Disbursement department's log to the SLD and USAC returned fund logs, noting no exceptions.
46. We obtained access to the SLD Returned Fund Table from the Oracle database (maintained by USAC) and agreed the records per Oracle database to the Returned Fund Log. We noted that all returned funds were restored back to the beneficiary funding amounts originally granted.
47. We performed the following for each returned fund selected from step 45 above:
 - a. We obtained remittance statements to support the initial disbursement of the funds subsequently returned. We agreed the FRN to the original USAC Remittance Statement and the funding amount returned to the initial approved disbursement of funds. For circumstances where only partial funding is returned, we ascertained that the amount returned was less than the original funding amount. We noted no exceptions.
 - b. We agreed the FRN and returned funds amount per the SLD Returned Funds Log to the USAC Returned Disbursement form. We agreed information per the USAC Returned Disbursement Form to the corresponding supporting documentation including copies of original checks returned, remittance advices for reimbursement checks from service providers, or other authorized

support for netted funds where the amount to be returned is netted against other Form 498 Universal obligation. We noted no exceptions.

Fund Management / Performance in Accordance with Available Funds

48. We inquired of USAC management and obtained copies of the procedures and controls utilized which ensure that the S&L Support Mechanism funding cap is not exceeded. We obtained an understanding of the controls in place to provide reasonable assurance that all Priority 1 service requests (telecommunication services and Internet access) are funded prior to Priority 2 service requests (internal connections) and that Priority 2 service requests are prioritized for funding based on the approved discount level of the applicant. We discussed the establishment of the contingency funding reserve maintained as a measure of protection for appeals or applications for which USAC may have made a processing error. In addition:
 - a. We inquired of USAC management and obtained copies of the controls in place that provide reasonable assurance that the amount and process for adjustment of the contingency funding reserve had been approved by USAC and the FCC Wireline Competition Bureau (formerly Common Carrier Bureau).
 - b. We obtained a copy of the spreadsheet prepared by USAC management noting the documentation regarding funding cap and the funding of Priority 1 service prior to Priority 2 service requests.

Outreach, Public Education and Web Site

49. We inquired of USAC management and obtained copies of the policies and procedures related to the outreach and public education efforts to date and the plans for the future. We also inspected the outreach website. We were informed that the USAC website is the parent site for the SLD outreach website.

Rule Changes

50. We inquired of USAC management and USAC SLD process owners and obtained copies of the policies and procedures related to the process used by USAC SLD which ensures that all FCC rule changes are identified, documented, and incorporated into the SLD funding process.
51. We inquired of USAC management and USAC SLD process owners and obtained copies of the policies and procedures related to the process by which they identified and reviewed the FCC rule changes that occurred during the period January 1, 2003 through December 12, 2003 for applicability to the SLD funding and approval process. We were informed that all FCC rule changes have been appropriately identified and reviewed for applicability to the SLD funding and approval process.

Appeals

52. We inquired of USAC SLD process owners and obtained copies of the policies and procedures related to the process by which they handle appeals from program participants. These appeals include:
 - a. Funding requests that were reduced and approved;
 - b. Funding requests that were denied;
 - c. Commitments adjustments (this may be due to 486 adjustments or other reasons);
 - d. Recovery of erroneously disbursed funds;
 - e. Audit Recovery amount (COMAD).
53. We obtained a data file of all appeals (the "Appeals data file") submitted since the inception of the S&L Support Mechanism. We extracted all Year 2003 appeals into a separate file. To select the sample size, we used a 90% confidence level and planned precision rate of 5%, with no expected errors. A total of 45 appeals (Exhibit XXXXII) were randomly selected from the total population of 15,162 appeals.
54. We performed the following for each of the 45 Year 2003 appeals selected:
 - a. We obtained the selected appeal and noted, without exception, the applicant name and appeal date to the Appeals data file.
 - b. We observed that the appeal correspondence was postmarked within the 60-day appeal window from the date the Funding Commitment Letter was mailed or the date of the 486 notification letter. However, for application # 292868, we were unable to obtain the supporting documentation for the appeal. We were informed that the record in the appeals database was created because of a data entry error in the application number. Management indicated that an additional record was created for the correct application # 292686 and processed in accordance with approved procedures. We were further informed that the erroneous record was not deleted in order to maintain database integrity.
 - c. We noted reasons for each of the selected appeals and read the underlying documentation supporting the appeal and ascertained that for those appeals where a decision has been rendered, the decision was in accordance with FCC program guidelines (e.g., eligible services, eligible entities, discount calculations).

DISBURSEMENT PROCESS

1. We inquired of USAC Billing and Disbursement personnel the procedures in place covering the disbursement process.
2. We were informed that service providers are required to file a Form 498 (which contains the banking information and the taxpayer identification number) in order to receive requested payments. We were further informed that the Form 498 must be accompanied by a signed letter on (service provider) company letterhead attesting to the accuracy of the information submitted to USAC. The process of submitting this form is referred to as “registration” and authorizes USAC to remit payment in the future.

To ascertain the propriety of the Form 498 we performed the following: from the sample selected at each support mechanism level, a random sub-sample of 45 disbursements per support mechanism (Exhibit XXXXIII) was selected for inspection and we performed the following for each:

- a. We obtained a copy of the Form 498 for each of the disbursements selected. We inspected each of the Form 498s selected and noted if all the required fields were completed by the service providers.
 - b. We inspected each of the Form 498s selected and noted if they were accompanied by a signed letter on company letterhead, attesting to the accuracy of the information submitted. We noted three exceptions for SPIN #s: 143002238, 143002342, and 143001736. However, we ascertained that the lack of a signed letter on company letterhead was acceptable as these three service providers had not filed a revised Form 498 since 1998, which we were informed was the effective date for this requirement.
 - c. We compared each of the service providers listed on the disbursements selected to the Form 498 database and noted that the service providers are included in the database. We noted no exceptions.
3. We inquired of USAC Billing and Disbursement personnel and obtained copies of the procedures pertaining to the receipt and processing of service provider invoices including the process that identifies invoices to be paid versus those invoices that are to be netted against the carrier obligation to the USF. We were informed of the process in place for debiting the service provider accounts for actual payments or netting against their obligation to the USF and how the service provider accounts are updated.
 4. We obtained a master payment file from the Accounting, Billing, Collection and Disbursement System (ABCD), which consisted of invoices approved for payment by NECA and disbursements made by the USAC Billing and Disbursement department for January 1, 2003 through December 31, 2003 and performed the following:

- a. We inquired of USAC Billing and Disbursement personnel and obtained copies of the policies and procedures related to the controls in place that provide reasonable assurance that payments are made timely.. We were informed that timely is defined as within 30 days of NECA approval.
 - b. Using the master file we extracted line items that are designated as SPIs into one file and those designated as BEARs into another file.
 - c. Using the master file we sorted the payments by BEARs and SPIs, then by Batch ID #. We observed the dates that the disbursements were sent to LaSalle Bank and noted that the batches were paid on a timely basis.
5. We inquired of USAC Billing and Disbursement personnel the process by which batches are approved for payment and the process by which they provide reasonable assurance that cash is available for disbursed funds.
 6. We obtained from USAC Billing and Disbursement personnel a list of service providers who are contributors and had a net amount due to them at December 31, 2003. 10 service providers (Exhibit XXXXIV) were randomly selected and we noted for each service provider that the credit balances at December 31, 2003 were subsequently paid by February 29, 2004, noting no exceptions. We inspected the supporting documentation, which included a check copy or wire advice and noted the payee, amount and date.
 7. We inquired of NECA the controls in place which ensure that monthly disbursements from the High Cost Support Mechanism are properly authorized, in accordance with USAC management's criteria. We obtained the disbursement authorization forms for January 2003 through December 2003 and inspected the forms for proper authorization, noting no exceptions.
 8. We obtained from the ABCD the HCL, LSS, LTS, IAS, ICLS, HCM and SNA payment amounts for March 2003, May 2003, July 2003, August 2003 and November 2003 and performed the following:
 - a. For the months selected, we compared the total monthly support payments per the disbursement authorization form to the disbursement report for non-pool participants and to the EC 2100 or Adjustment report for pooled participants. We noted the following differences:

Month	Support	Difference
March 2003	High Cost Loop	\$(1,708,914)
March 2003	High Cost Model	\$ 1,708,914
May 2003	High Cost Loop	\$(2,126,056)
May 2003	High Cost Model	\$ 2,126,056
July 2003	High Cost Loop	\$(2,566,378)

July 2003	High Cost Model	\$ 2,566,378
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- b. We inquired of NECA the controls in place that prevent a carrier from receiving a support payment twice, once through the NECA pool and then directly by the USAC Billing and Disbursement department. We were informed that there are preventative controls in place.
9. We inquired of NECA the controls in place which ensure that monthly disbursements from the Low Income Support Mechanism are properly authorized, in accordance with USAC management's criteria. We obtained the disbursement authorization forms for March 2003, May 2003, August 2003, and September 2003 and inspected the forms for proper authorization. We noted no exceptions.
10. We obtained the Lifeline, Link-up, and Toll Limitation support payments for March 2003, May 2003, August 2003, and September 2003. For the months selected, we compared the total monthly support amount by type per the disbursement authorization forms for pool and non-pool participants to the PSPS28 for pool participants and to the disbursement data file for non-pool participants, noting no exceptions.
 - a. We noted that for the months selected, USAC management authorized the funds transferred from USAC to NECA, and that the amounts did not exceed the total amounts due to carriers that are members of the NECA pool.
 - b. Using the sample of 45 carriers selected in Low Income step 2, we compared the support amount requested by each of the 45 carriers to the amount disbursed to each carrier by USAC for non-pool participants or by NECA for pool participants. We noted no exceptions.
 - c. We inquired of NECA the controls in place that prevent a carrier from receiving a support payment twice, once through the NECA pool and then directly by USAC and were informed that there are preventative controls in place.
11. We inquired of USAC management, USAC Billing and Disbursement personnel and NECA the procedures in place to inform USAC that the support payments authorized for payment were paid, and were informed that for payments to non-pool participants a monthly analysis of outstanding checks and payments is performed. We were informed that for payments to NECA pool participants there is no process in place to inform USAC that what they had authorized for payment has been paid. We ascertained that there are no controls in place, beyond the point of submitting funds to NECA and disbursements to LaSalle Bank, which confirm payment to the carrier.
12. We obtained a variance analysis of administrative expense detail for the period from January 2003 through December 2003. For those administrative

expenses with variances in excess of 20% (when comparing 2003 to 2002), we inspected invoices for disbursement authorization.

13. We inquired of USAC Billing and Disbursement personnel the procedures and controls in place for identifying and implementing the choice that carriers had made for either netting or non-netting of contributions against reimbursements for qualified universal service rendered to the Schools and Libraries Support Mechanism. Using the sample of 45 Schools and Libraries Support Mechanism disbursements selected in step 31, we inspected the Form 498 for each service provider and noted that 41 service providers elected no netting and 4 service providers elected netting. We noted no exceptions.
14. We compared the FCC fourth quarter 2003 projected demand filing to the summary of the amounts netted against contributions and/or disbursed directly to carriers for the fourth quarter 2003 and noted that in total the amounts netted and/or directly disbursed did not exceed the total FCC projected demand. We noted that by Support Mechanism, the amounts netted against contributions and/or disbursed directly to carriers for the High Cost, Low Income, Rural Health Care, and Schools and Libraries Support Mechanisms did not exceed projected demand by Support Mechanism by \$29,254,000, \$4,299,000, \$4,709,000 and \$764,477,000, respectively.
15. Using the sample of 45 Rural Health Care disbursements selected in Rural Health Care step 19, we noted that 38 of the disbursements were netted and 7 disbursements were not netted. For the 38 disbursements that were netted, we agreed the disbursement credit to the carrier receivable balance. We also noted that the 7 non-netters were not contributors to the Rural Health Care Support Mechanism.

For the six disbursements that were not netted, we obtained the Form 498s and noted that the service provider elected not to net. For one disbursement (SPIN #143010651, invoice amount \$52,853) that was not netted, there is no record of payment; however, we inspected the NECA disbursement authorization file and noted that the invoiced amount has been authorized.

16. We inquired of USAC Internal Audit whether any internal audits were performed in 2003 in the application, commitment, or disbursement areas and were informed that no internal audits were performed in these areas in 2003.